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The Province of Alberta

IN THE MATTER OF "THE NATURAL
GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into
Scheme to be adopted for Gathering,
Processing and Transmission of
Natural Gas in Turner Valley

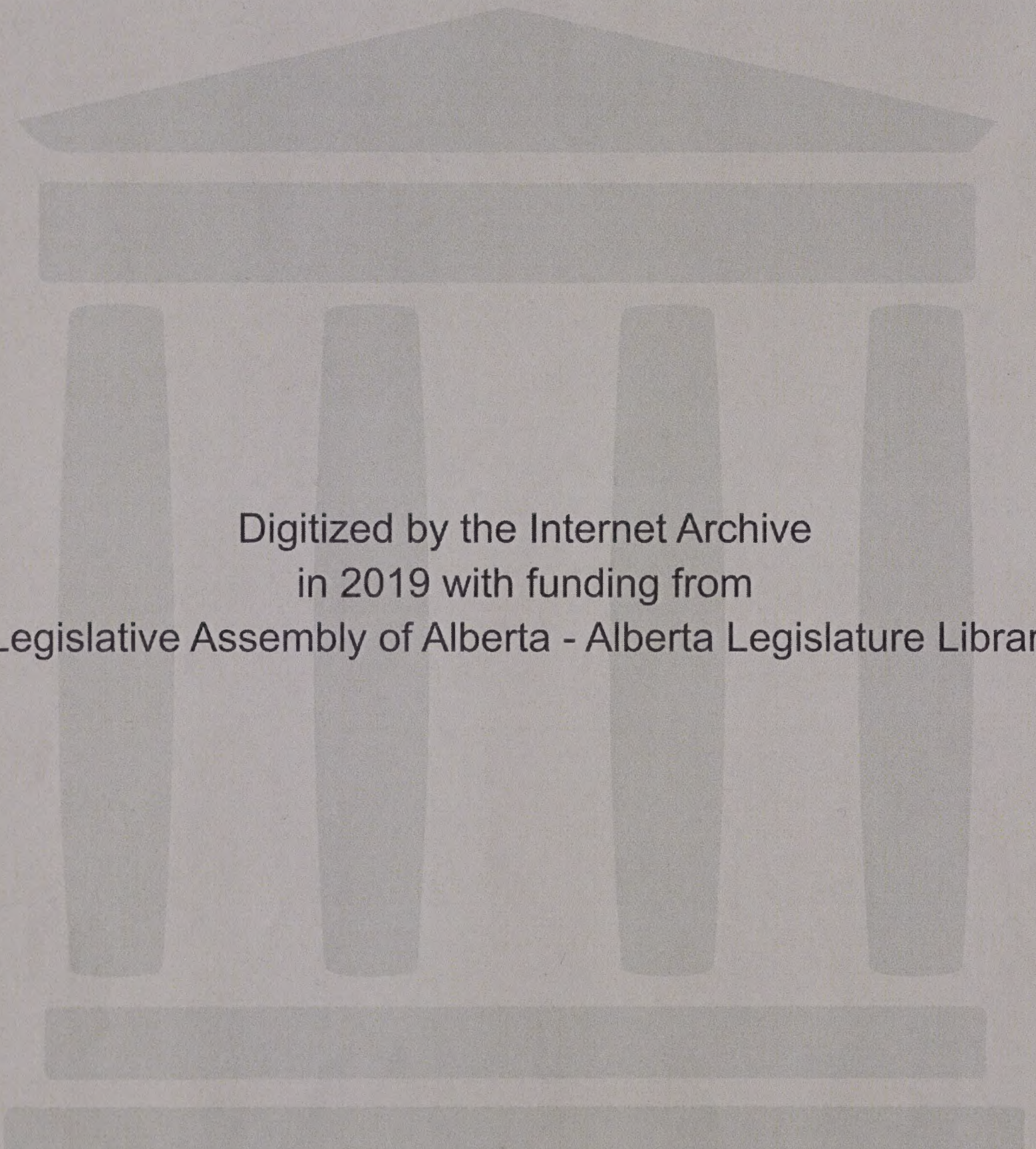
G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta June 19th, 1946

VOLUME 89



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MR. FENERTY: We come now to the question of the consideration of what I say is a subject matter before this Board, and to that part of the subject matter that we are particularly concerned with, that is the price of gas at the exit of the absorption plant.

Now I think there is common agreement that in the past we have had a successful integrated operation. You may remember that one of Mr. Hill's items of valuation, yes, Mr. Hill's items, in considering going value and so on was that there had been a successful operation and that part of that successful operation was being taken over by the Madison Company, that part related to dry gas, and we have had a successful integrated operation latterly and before the institution of this Inquiry on the basis of $7\frac{3}{4}$ cents, less scrubbing costs at the exit of the absorption plant, that is, $7\frac{3}{4}$ cents at the exit of the scrubbing plant, but for the purposes of our Inquiry I am considering the gas at the exit of the absorption plant.

Now Mr. Zinder, and I think all of us agree, that when you have that kind of condition, when it is working and where the economy, so far as fuel is concerned, has been built up on that condition, that you must establish an excellent reason for a change.

Now there I say in this very complex and difficult question where, so far as I can see we have no other logical starting point; there, I submit, is our starting point.

First: The place where you get the gas and secondly, as to price, the price being paid for it on

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the conditions that existed prior to the enactment of this statute.

Now I understand that in part of Mr. Weymouth's submission, he suggested that his plan or that part of the plan so far as we are following it, conferred benefits on the Producers in the gasoline industry.

Now it does seem to me, -I am not an economist but I hope I can use some practical common sense, but it does seem to me that if you have a situation under which you have a successful integrated operation, we will say at $7\frac{3}{4}$ cents, and if the parties who are conducting those operations have been conducting such a successful operation and at those figures and if they are going to get some added benefit from what is going to happen, that should necessarily result in cheaper gas. That is just the law of the economic world. Somebody is going along with a successful operation if they are going to have some benefits handed to them, either they are going to make more profits or they are going to get less for their gas, otherwise it is not a benefit. That is just plain ordinary economics.

Now with regard to the $7\frac{3}{4}$ cents, as pointed out by the Board, there has been no breakdown of that price and I do submit that that is not due to any cessation of effort on our part at all events; that there has been no breakdown of that price, and I suggest to you then that that being the case, and if a good reason for a change is required, that there is a total lack of evidence on which to base any increase at least for that purpose. If we are correct in suggesting that we must consider gas at the exit of the absorption plant and if, apart from new

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installations, we then have to consider the costs up to that point, such as scrubbing plant costs, and as we know now, they amount to only a fraction of the $7\frac{3}{4}$ cents, then I say again, in the absence of a breakdown of that figure, a figure which resulted from a successful operation, that there have been no grounds established and no evidence adduced on which a change at least can be made.

I suggest that any theory that everyone benefits from the condition and that the price must still go up, has got something wrong with it. It is just against all the laws of economics.

THE CHAIRMAN: What about Public Utility law?

MR. FENERTY: Well there, very fortunately, our Public Utilities Act has made it "just and reasonable.", and anything I say which infringes the laws of economics cannot be just and reasonable. You have to correlate them.

THE CHAIRMAN: I do not know, Mr. Fenerty. You once had the common law and it was not just nor reasonable, so you had equities stepping in to help out where the common law was defective.

MR. FENERTY: That is quite true.

THE CHAIRMAN: And with advances in things which we have today, we now have the Public Utilities Board to make up some of the deficiencies of both the common law and equity.

MR. FENERTY: But at the moment I am merely advancing that argument to show that such a result is not just and reasonable and therefore it infringes the Act we are dealing with. That is my position so far as that is concerned.

THE CHAIRMAN: We might say it must be "just and reasonable within the law", as it applies to public utilities.

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MR. FENERTY: Again I suggest that the laws as they apply to public utilities mean "just and reasonable". They must be. That is the yardstick.

THE CHAIRMAN: Yes, but the result might be somewhat contrary to your laws of suggested economics.

MR. FENERTY: All my arguments I submitted to the Board are, I hope, or are meant to point to the proposition that what is common sense is what is just and reasonable, I think the two go together and are the test and if any of these theories do not stand those tests, then we turn to the Act itself and they must be necessarily excluded. That is my general submission.

Now I am going to refer a little later, perhaps at some length, to the question of this competitive price, and I am referring particularly to Mr. Galloway's offer

MR. HARVIE: I am sorry. We cannot hear you, will you speak a little louder please?

MR. FENERTY: All right. I am going to suggest that Mr. Galloway's offer for the gas of the Princess field is an offer made by a reputable company, by the General Manager I believe of the company, a company which has spent many hundreds of thousands of dollars and drilled many wells. It is an offer made in good faith, and that offer must, as Mr. Zinder says, apart from any matter of government policy, set the rate of what can be charged.

You, Mr. Chairman, did suggest at page 4186 that there might be some division of the markets in that case as a result of that offer.

Now just in passing I want to suggest

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this, that there can be no government policy which deprives the City of Calgary of all the benefits from adjacent gas fields and confers all those benefits on the City of Edmonton, and I am referring especially to the price the reduction in the Edmonton rate now in existence.

If it is a matter of government policy, it follows, I say, that it must be an obligation on the part of the Province as a whole, to bear all expenses which would result in equalizing the rate throughout the Province.

I say that if there should be any government policy which dictates a 20 cent rate for Edmonton and a 30 cent rate for Calgary and there is gas available from another field at 25 cents for Calgary, that is just, I submit, it cannot be done as a matter of justice or equity, government policy or anything else.

If that be a matter of government policy, it inevitably follow that the consumers of gas in the City of Calgary are dedicated for all time to the support of the gasoline and oil industries in Turner Valley and I say again there can be no such government policy.

THE CHAIRMAN: I suppose there has been some benefit from that, Mr. Fenerty.

MR. FENERTY: Yes.

THE CHAIRMAN: The City of Calgary has gained some benefit from Turner Valley being adjacent and producing oil.

MR. FENERTY: Some benefit, yes, undoubtedly, yes.

THE CHAIRMAN: I mean, even I know, that the legal profession has done exceedingly well out of Turner Valley.

MR. FENERTY: But I suggest it should get the benefits from this being a residue product and in my concluding argument

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last night I said that it is impossible, I submit, to say that the City of Calgary has benefitted when as a result of the oil operation it pays more for a residue product than other parts of this Province pay for a primary product, - that is just the reverse of the normal law of economics. That is my proposition.

Now is that a benefit or is it a detriment?

THE CHAIRMAN: Well if your production costs are different, Mr. Fenerty, and you know they are different, your production costs for the Edmonton gas do not begin to measure up to the production costs in Turner Valley.

MR. FENERTY: Yes, but the key of the situation is, there are no production costs for a residue product. That is the reason there can be no possibility of the residue product costing more than the primary product. There are costs of course added for scrubbing but there are just no production costs for a residue product. There are production costs for a primary product, and as a result of this being treated as an oil field and operated as an oil field, and gas produced that there is no market for, because it is an oil operation, it is proposed that we will pay more for the residue product that has no production costs, than for the primary product that has a lot of production costs, including the drilling of wells.

THE CHAIRMAN: Are you suggesting because it is a by-product that the producer should just hand it over to the Gas Company and say "here it is, do what you can with it."

MR. FENERTY: I am sorry, I did not get that.

THE CHAIRMAN: Are you suggesting that the producer of the by-product should hand it over to the Madison Company for nothing?

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MR. FENERTY: No, I am suggesting that that part of it which before escaped into the air, if he insists on producing and blowing it off into the air, that it, as a matter of government policy that is not going to be permitted but it is going to be captured and Dr. Katz agreed that the person who captured it and spent some money on it should own it and there is some proportion of the price to the producer . . .

THE CHAIRMAN: Which he is allowed to do by law, Mr. Fenerty. He does not insist on doing it. He has a legal right to do it.

MR. FENERTY: He has a legal right to do it because under the Brown Plan that gas has fulfilled its economic function.

I will repeat again, you have two views, first it is a scientific plan for the production of oil, which involves that the gas has fulfilled its function or it is an unscientific plan for the wasting of dry gas and I say it is a scientific plan for the production of oil and it necessarily results in the gas, having fulfilled its function, the Government plan says it should not be blown into the air as a part of the Government scheme of conservation of gas for this Province as a whole.

THE CHAIRMAN: Then do you say it is of no value, that it has no value?

MR. FENERTY: It has a value if it can be manufactured and delivered at some point in competition with other gas, at the same pressure and with the same B.T.U.'s on the date when it is delivered.

THE CHAIRMAN: You cannot bring gas from Viking to Calgary and get it at the same price that the Edmonton people pay for it.

M-1-1 - 10.15 A.M.

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There are some interesting questions there, some very interesting questions, but whether that can be done at all events we have not the evidence on the point but I realize there might be a question in relation to the gas supplied at Lethbridge, Okotoks, and some houses being supplied outside of the city limits of Calgary at Manchester and so on and I do not think I know the exact answer. I think it complicates the situation on the point, at the moment, that I am trying to make.

Now then I say again that the $7\frac{3}{4}$ cents for scrubbed gas is the upper limit of price. In other words I say it is indicated by the comparison with competitive fuels that I am going to discuss later, but I do say this, that if for any one of the reasons I submit $7\frac{3}{4}$ cents is the upper limit our consideration should be to the question of whether or not the effect of the evidence led here establishes any reason for a reduction from that price and I am going to treat that as a separate factor. One thing I am mentioning is that we have the cheapest money we have had for ninety years. That is just one matter.

Then we suggest further if our views as to where we start are not acceptable to this Board and some consideration is given to the price at the well head of dry gas I still do not understand it but I still think it is a fiction to think of discussing the price at the well head for something that is not there and I think you might just as well talk about something at Wainwright if it is not at the well head. There is no more reason for mentioning that well head than any other well head, but assuming for certain reasons that the Board does not agree with this view we arrive at

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the discussion of the price of dry gas at the well head and we then have to consider the price being paid, 2 cents, and leaving out the 80/20 at the moment and treat that as if it was dry gas and the 2 cents as if it was dry gas and I say it necessarily follows that if we have a base of $7\frac{3}{4}$ cents and the 2 cents that if any figures are adopted I suggest involving treatment of gas resulting in a cost in excess of the difference between that two cents and $7\frac{3}{4}$ cents, it necessarily follows that the difference must be deducted from the 2 cents.

Now there is one thing that is clear, there is certainly no ground for disturbing the 2 cent figure up and it is clear that this gas at the well head has no expense of production. I think everyone of those who take a different view from me will agree that when that gas can be used as a gas lift and goes through the absorption plant and produces so many barrels of oil that nobody would have the temerity to suggest that there is expense in producing that gas. All they have to do is to figure their expense if they did not have it. If they had an eight or nine thousand foot well they could not even run it on a pump proposition with the paraffin they have. But, that is something else, but as to its being an expense it is one of the most important benefits of the oil industry. So they have no expense as to that 2 cents at the well head, no expense of any kind.

Now if there is expense in making that available and getting some money out of it which results in some expense and the difference between the price they are getting and the upper limit established if my argument is correct, must come off the 2 cents. There is no reason why there should be a complaint. It is idle to talk about that, you cannot force

people to produce at less than production cost. There is no cost of production and if there is an expense up the 2 cents they are still getting a benefit and it is not just worth that difference at the well.

Now then, just before coming to some of the other specific things, I want to say a word or two about general principles. They have already been dealt with by my friend Mr. Steer and perhaps I am attempting to paint the lily by anything that I may say, but I have just one or two suggestions.

I suggest that it is completely idle to refer to the long line of cases dealing with the principles that should be applied in particular cases even if my friend Mr. Steer had not read the later comments of the Supreme Court on the Hope case and the Ames case. I say we can get no comfort for either side by referring to them. It is common ground that all of us can pick out cases for our argument at the moment.

You may remember, and perhaps I was in error in doing it, but I referred to a group of cases in Benbridge at Page 508. I could take two hundred of those cases in establishing historical cost or original cost in answer to some ten or twelve that my friend cited, and he could have cited just as many as I could in support of his proposition and he could cite many cases in the United States as they are on the considerations of the Board in the interference with vested rights, constitutional rights and powers. They are problems we do not have here.

In answer to his reference to a Commission report advocating reproduction costs I could have referred again in emphasizing the Wisconsin Commission report in making the

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most severe strictures on anything but a historical cost, but I say that none of those things are in point. We have here an entirely new set of conditions. We are talking of a different period and I say that is the reason why the Act we are working under provides us with certain yardsticks. Provides us with yardsticks that we can use. We can use some and discard some, or use them just as the Board sees fit always having in mind that it is the result that is sought and that whatever combination will produce a just and reasonable value or price, a just and reasonable result is the whole thing.

I would suggest that the situation under our Act is exactly that referred to by Judges in the Supreme Court of the United States in the Hope case. I have it here, where they say:

"We held in Federal Power Commission vs. Natural Gas Pipeline Co., supra, that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate making function moreover involves the making of pragmatic adjustments. Id., p.586. And when the Commission's Order is challenged in the Court, the question is whether that Order viewed in its entirety meets the requirements of the Act. Under the statutory standard of just and reasonable it is the result reached, not the method employed which is controlling."

Now I suggest that my friend Mr. Chambers spent some time in citing English authorities on expropriation cases in disagreement with that proposition.

Then I suggest that another method of approach approach is to consider the money we have to deal with. My

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friend, Mr. McDonald, recognizes that when after dealing with an approach from the ground up, or the bottom of the well up, which Mr. Zinder and others did not recommend, he said that he did not recommend that because we must realize we might not have enough money to meet the situation. We might not have enough money to meet a lot of these situations which on theory bring you up to a certain price and the last state of the industry might be worse than the first state.

We must consider not only all of the elements that go to make up the price of the residue product but how much money we are going to have to meet it.

I suggest to you that I think statistics do show and the statistics of the Gas Company do show in some places that increased price did not necessarily produce more money but do tend to lessen the number of consumers and ultimately reduce the total available.

I suggest to you where we now have cheaper gas in other parts of Alberta we are going to have trouble enough to maintain the market that we have now, particularly in manufacturing and commercial plants. We might have trouble even in maintaining the gas in a reduction of price let only reducing those prices.

THE CHAIRMAN: You meant to say increasing them instead of reducing, the last sentence.

MR. FENERTY: What I meant to say was that we might have trouble enough in maintaining our existing markets for gas without any increase.

Now I want to discuss this question for a moment considering what has happened in the past. I quite realize the force of some of the arguments advanced that we

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should divorce ourselves entirely from the past. I have always felt that what has happened in the past was found one of the most successful guides to what could be done in the future, or even what should be done in the future. I think that still holds good even in utility practise.

I want to comment a moment on Mr. Hamilton's figures in dealing with things that happen relating to a five year average. Its application will appear presently. I want to suggest that the use of averages is entirely misleading. Where you average in that case five abnormal years. We cannot obtain a normal figure from the average of five abnormal years.

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H-1-1. 10.00 a.m.

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You have just got an abnormal average insofar as it relates to the ordinary matters. And I am going to suggest that as far as we know from the evidence, that probably in 1948, or in 1947, but certainly in 1948, that that year would be a more nearly normal year than the average of the five abnormal years, and that has some bearing on what rate should be considered at the present time.

We suggest that on a reasonable basis of computation, and on the inclusion of various items in the rate base and the exclusion of others, which we will suggest in detail, a figure of $7\frac{3}{4}$ cents will be arrived at. And we further suggest that that figure which might be arrived at, on the basis of that figure, producing a surplus during the several years that are past since this Inquiry was originated, and that in itself is necessarily not objectionable provided that the figures below are not greater than the $7\frac{3}{4}$ cents. And that may result from the abnormal situation of those several years. And that if that result is obtained, that surplus should, of course, be available to reduce the rate base and so maintain the costs in balance with the declining revenue for the next several years, and pending further rate hearings.

And we say that any such surplus for the past several years, and I make a distinction there, and it was in the evidence, that on the basis of $7\frac{3}{4}$ cents or less, that that should not go to the producer and resulting in possible losses in the following period being capitalized and added to the rate base to the prejudice of the consumer. It would also inflict a hardship on the consumer to fix a price per MCF based on a decline from the war years which would increase the surplus for the past two years, particularly if that surplus were used for the benefit of the producer.

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Now, I want to come to this question of dual operating costs. As I said before, irrespective of whether effect is given to the argument that you start downstream from the absorption plant, and in considering that and also considering the old installations with regard to the starting point, and taking it in that connection that they do not meet the views of the Board, we have two things to consider, that is, the divisions of operating costs and the divisions of capital costs. Now, let me say that our suggestion is that capital costs and operating costs should be divided in the same way. I can find no basis for a different approach in each case. I do not understand the basis for an approach such as has been suggested, and I suggest that the logic of the situation inevitably leads to a division on the same basis, except in perhaps some minor instances, where there is an operation in itself that is taken with regard to increment costs such as compression or something like that. That is the view we take. We submit that in considering this question of dual operation, dual costs, a distinction must be made between gathering and compression costs on the one hand and repressuring costs on the other.

Mr. Davies points out that I referred to compression costs, or I said compression, I should have said repressuring. I suggest that repressuring costs are in a category by themselves, and that even if the Board feels that there should be a division of the gathering costs, that does not necessarily involve a division of the repressuring costs. Now, I am talking of repressuring as distinguished from compression. I say to you that the repressuring has nothing to do with the conservation in the ordinary sense, and is not an operation leading to any new reserves except that it leads to

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new reserves in the Bow Island Field, for that field alone. That was the distinction I made before. It is purely and simply an oil operation involving the taking out of the gas from formation and putting it back again.

Now, you cannot justify doing that on the basis of a dry gas operation, as every dry gas operation, and every witness says, consists of taking the gas out of storage and using it, and you have not this problem. This repressuring consists of taking it out and putting it back. There can be no economic justification for that except the benefits that two industries get from it, and the only two industries that get any benefit of taking gas out of the formation and putting it back, is the oil industry and the gasoline industry, and that is where you get this 20% for the oil industry and the gasoline gets the 80%, and nobody in this room can say that there is any benefit to the user of dry gas/^{of}taking it out of the formation and putting it back, and if anyone can say that in this room, well it is beyond me, that is all.

Now, I think it is noteworthy that everyone so far who has suggested the repressuring costs be paid in part at least by the consumer, justifies it on the basis of creation of new reserves, and I recognize as well as anybody else that this operation of the drilling of new wells gives us a supply, and is finding new reserves, and that is one thing to consider, but you are not creating any reserves by shifting the gas from one place to the other, and in no way do I suggest that you do.

I have some references here which I will pass over as quickly as I can, as to the suggested benefit to the oil industry from repressuring.

I say we do not need to find any benefit from repressuring because it is solely an incident of getting the

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oil and getting gasoline, and that is the only reason you have to do it, and the only excuse is that you take it out, and you do not need to use it as dry gas and you are putting it back again.

And now with regard to some of the benefits from putting it back again, and I have some additional references here. As I interpret Mr. Coils' evidence at page 268, Volume 5, he says that the effect of storage is to prolong the life of the oil wells. And then at page 26 Mr. McCutchin says it will benefit the oil industry, and then at pages 22 and 2613 he says that it will increase the oil production.

And then both Ralph Davis and Dr. Katz think that there will be some migration following repressuring, and that is found at pages 304, Volume 5, and page 606, Volume 9. And Dr. Katz adds that to the extent that migration from the gas cap to the oil takes place, there will be a benefit to all oil and gasoline operators. Pages 558 and 608 and 609 in Volume 9, And incidentally gas that does so migrate and is used again for gas lift will be paid for twice over, if anyone but the operator pays for it now.

As I suggest, it is common knowledge and it is indicated by the evidence, that preservation of the gas cap results in greater oil production down flank in the oil wells, as pointed out by Ralph Davis at page 861, Volume 11.

And Mr. Davis also points out that repressured gas may not reach the consumer at all, that is at page 302, Volume 5. And as previously pointed out, under circumstances such as these, operators in other fields are charged with it and carry out the repressuring operations for their own benefit.

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Now I want to comment a moment on my learned friend Mr. McDonald's reference that repressuring in the States is an actual operation as distinguished from the storage operation, which he says is the case, and he referred to Davis' evidence, indicating as he did that repressuring in the States relates to crude oil operations, but suggesting here it is a form of storage.

And I submit that that does not assist the oil operator or the gasoline operator in establishing that repressuring is an obligation of the dry gas industry. Certainly, if it is a matter of storage, it is not a matter of conservation. You are not conserving something that you already have, and you are just preventing it from being wasted. You are just reversing the whole situation, the whole economics of the thing. If you want to treat it as an oil operation, as Mr. Davis states, well and good, let us keep it as an oil operation. If you want to treat it as a matter of storage, as Mr. McDonald says it is, it is simply a matter of moving from the cheapest storage there is to the most expensive storage there is, in order that two industries will get something by doing it. First, the oil industry, and secondly, the gasoline industry. And can anyone suggest why on the basis of storage, moving from the cheapest storage there is to the most expensive storage there is, to give two parties a benefit, should that result in payment of those costs by a third party, who participates in no way.

Now, I think I can usefully eliminate a couple of matters here. I understood Dr. Katz to say, and I agree, that when you consider some of his remarks in answer to other questions that there might be some doubt in the correctness

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of my interpretation, but I understood Dr. Katz to agree with that if gas is produced at a time when there is no market, and it has no economic value unless captured, that those who spend the money on it to capture it, and I am speaking now of flared gas, that would otherwise be flared, should own it.

Now it is not proposed for the present consumer to own it. It is not proposed that he should have any interest in it, and it is completely uncertain whether they either can or will use it at the expiration of fifteen years when it might become of use.

Now, I think that Mr. Davis, Dr. Katz, Mr. Mercer and Mr. Stanley Davies all agree, I think I am right in that, that the gas if and when used should be paid for by the people who use it. And I have one reference to Mr. Mercer's evidence here, at pages 2579 and 2582 in Volume 33. And I am going to suggest to the Board that he analyze, no matter what conclusions Dr. Katz arrived at, that the analysis of Dr. Katz' evidence with reference to that repressuring gas, made by Mr. McDonald several days ago, shows a most conclusive reason why it should be paid for by those who use it, use that particular gas, rather than the present consumer.

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T-1-1 10.45 A.M.

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I invite you to consider for a moment the situation that if by reason of pressure difficulties or by reason of a change of policy or for any of many reasons which might come into play repressuring were to cease before the gas that has already been repressured was required for use, say 15 years hence, I say it would be the height of absurdity to have required individuals who happen to burn gas today to pay in full for the gas someone else would burn 15 years hence. There would be an anomalous situation if the gas were produced primarily for the benefit of A, and if finally consumed by and with benefit therefore resulting to C, with additional benefits to A when it is consumed, but that it has been paid for in the meantime fully by B. It is produced for the benefit of the oil and gas industry. It is consumed by the consumers some 15 years hence, with some further benefit to somebody and in the meantime it has been paid for in full by the consumers of today. That is the situation if repressuring ceased at any time in between. That just cannot be done in reason and justice or anything else. I am going to suggest to this Board the proposition that the people who use are the ones who should pay and I want to emphasize right here the distinction between the City of Calgary and its users. We are here representing the City of Calgary and the City of Calgary is here advocating the interests of the users of the gas in the City. We know that. The City of Calgary, as a city, is the user of dry gas, just to this extent that it is used in some boilers in some schools or something like that. As far as the consumers are concerned, they are a changing group from time to time and certainly those who are consumers today, many of them will not be consumers in

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15 years' time. Many of those who would get the benefits from payment today by the present users are not even residents of the City of Calgary today. If the people who use it under agreement, a group of citizens or individuals, a large number of individuals and manufacturers and commercial users, but the individuals being the larger number and being the people who pay for that today, you cannot put it into those rates and I say I realize there is one place where perhaps in decided cases we are committed to the principles of the user of today paying for something that may be used in the future, but the only place I know of that is in the search for new reserves and to apply the principles which have been applied to the search for new reserves in a case where you are preventing the dissipation of an existing reserve, I say it is just an incredible proposition.

Now I suggest to the Board, and the Board itself has a leaning towards that theory, that the people who use the thing should pay for it. Certainly that is done outside the gas industry. In every other walk of life the people who get it are supposed to pay for it. A large number of individuals who have the theory that they should get something and do not pay for it are in the Penitentiary. In every other walk of life that is true, when you get a thing, you pay for it, and those are the people who ought to pay for it.

I want to refer you to one quotation in the Valley Pipeline case. It was not referring to this situation and I recognize the danger in applying remarks taken from the context to another thing, but at page 86 you, Mr. Chairman, the Chairman of that Board, did say:

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"Unit depreciation has the added advantage that the utility customers in the later years of the system's life will pay their proper share of depreciation."

I see no reason why those remarks cannot be applied to the utility customers in the later years of the life paying for the thing that they get and the utility customers in this year of its life paying for what they are getting.

Now I want to refer for a moment or two to the distinction between the construction in the South End and the North End of the field and again between new and old construction in the South End. I say that so far as old construction in the South End is concerned, it is common ground that it was a wholly gasoline or gasoline and oil operation in the cases of both the G.O.P. Company and the British American Company and I say it follows it is wholly outside the scope of this Inquiry. As the G.O.R. submission says they just got something added. It is one of those windfalls that you get when you get benefits; you do not usually expect to get something in addition at the expense of someone. Mr. McCutchin, I say, clearly indicated that at page 21 and page 56 and the G.O.P. brief certainly indicated it.

Now I suggest also that the B.A. new construction in the South end is not only in a somewhat different category from the old B. A. construction, but it is perhaps in a somewhat different category from the Madison new construction in the North End. I suggest to you my reading of the evidence of what took place at the time is that that construction took place under what I have termed

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a permissive order rather than a mandatory order. That has been dealt with by other counsel and reference has been made by the Board. I realize that notwithstanding the fact that was done under what I call a permissive order, that the B.A. apparently were fully willing to assume the risk. But the fact is it was constructed under an order of this Board and this Board had in mind some benefits to the dry gas industry. If we do not agree that it does produce a benefit except on the basis of a waste product at a nominal charge, but it was put in on that basis and in fairness and justice some consideration must be given to it. I do say, however, that it is now apparent that order, whether it is permissive or mandatory, was introduced by an unfortunate error or representation; error, which is also a representation as to cost which turned out to be incorrect. It does seem to me on that basis, having in mind it was largely permissive and having in mind the extraordinary benefits to that plant in the prolongation of its life that the Board might well consider those costs on the original estimates rather than the final result. My suggestion, then, is that on the dual operation basis, the maximum equipment that should be considered in discussing the rate base consists of the B.A. new low pressure gathering lines and compressors; the Madison gathering lines and compressors and of course those steam and electric power items which do not present any real problem as to the division of use. We have got that definitely.

Now our suggestion is that on any reasonable basis and on the basis of a division both of the operating costs and the capital costs in the same percentages, and with the exclusions we suggest that should be made, items

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that should not appear in the rate base at all, that a 50-50 basis, whether on a volumetric or a sales realization basis would be a reasonable one. I am speaking at the moment of Madison. I agree with my friend Mr. Steer that so far as the B.A. construction is concerned that perhaps he is being reasonably generous in suggesting a 25% and 75%.

Now dealing with this sales realization and volumetric basis I have another suggestion to make once we settle on the 50-50 principle and that is that the oil industry appears in the picture and there should be some further division on the basis of the oil industry getting into this thing. But at the moment I am talking now as between these two, As the Board fully realizes, of course, in the early stages of the Hearing, Mr. Latham advanced the proposition that a scientific basis would be a sales realization basis and the sales realization principle should be adopted. His remarks are to be found at pages 208 and 210. Later Mr. Kirkpatrick, with equal seriousness, advanced the volumetric argument on the basis of the cubic contents removed without regard to what elements were removed or their value. I suggest Mr. Donellan on the stand completely demonstrated the unsoundness of that theory. I say Mr. Donellan at page 3279, Volume 42, agreed on cross-examination that if Mr. Kirkpatrick's method was going to be used as a scientific method, it is necessarily based on the theory that 15% of the elements going to make up the gas are taken out and that 85% of the elements remain. It might be 17 and 83, but I am saying 15 and 85.

Mr. Stevens-Guille, at page 3339 gave me statistics which show that that was not the case, and

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where he told us that what is removed from the absorption plant is perhaps 80% of the iso-butane content and 3 to 4 percent of the methane content and some of the heavier hydrocarbons. What would my friend say to me if I came in here and said that they had taken all the heavier hydrocarbons and on the basis of this submission they must bear 100%. Certainly it is more logical than the other thing that has been said. As has been pointed out by Mr. Steer, he pointed out many times the absorption plant takes, requires and treats 100%. I was under the impression that that worked out at a fraction of $\frac{85}{185}$ but my friend Mr. Steer has gone into it fully and he said $\frac{100}{185}$. There is not a great deal of difference but the principle cannot be controverted. I say that looking at it now from the sales realization basis - my friend Mr. Chambers filed an exhibit, I have not got the number at the moment but it is the one dealing with the absorption end, demonstrating I take it the absorption industry in its more favorable aspects but demonstrating on a hypothetical state of facts and not a state of facts as they exist today. He is demonstrating not only on a state of facts which do not exist, such as depreciation and all that sort of thing and I am not going into the details, but he is demonstrating it on a state of facts also that does exist as to price. That is a managed price. As Mr. Steer pointed out in an Exhibit now before us on any basis of competitive prices or on any basis of values, price should be almost three times the managed price which could only exist either because of a by-product operation or because of a wholly owned subsidiary. I do not care which we take. In either case it is no yardstick.

M-2-1 - 11.00 A.M.

Argument by Mr. Fenerty.

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Now we know at the moment what competitive prices will be, thanks to this statement, and we pretty well know or suspect from the annual reports that have been put in and so on what actual depreciation has been taken for the absorption plant operation, and I am going to submit to the Board that a very sure and simple calculation on what we know and what the annual reports show, that if you were to take the absorption plant operations on the basis that they must be taken and on a non-utility operation, as I understand it then there is no possible reason for talking about income taxes and this thing or the other. Take it on the non-utility basis and I will suggest that a short calculation will show that not only can the absorption plant operate at a reasonable or even at a substantial profit but on that basis of competitive prices and on the basis of what they have to pay dividends on and what they have to retire that a sales realization method will have been brought very close to the 50-50.

I say another reason why that is fair, apart from the actual cost calculation. Again as I remember Mr. Donellan's evidence, that if we pay any part of the charges in connection with that 100% cost to the absorption plant that we are entitled to some of the benefits in the absorption operation. I agree we are not entitled to that because I agree the Act does not contemplate it and Mr. McDonald points out excluding the gasoline content you exclude considering whether the gasoline content is in it. I do not want to repeat it but whether we are not going to get any of those benefits or whether we do, this cost of the gathering line involved in the 20-25% cost due the absorption plant operation surely that is a generous treatment of the north end whether you take it at the sales realization method or the

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volumetric basis.

Now then, having found we should not bear more than 50% of the cost of gathering, not any, but in the alternative not more than 50%, I want to talk a moment about the situation of the oil operator.

I have in mind particularly, and perhaps these remarks are more aptly addressed to the situation of the oil operator who gets on the line now for the first time rather than those who were on prior to the construction.

I suggest to you that the producer has three benefits from this gas. He has the gas lift which he is entitled to and we cannot criticize that or have anything to say about it, but it is a benefit.

He has an additional market. I am speaking of the new man for his 20% gasoline content and for his dry gas, his share of it.

The gasoline industry has two additional benefits and they get something extra, something for nothing in the sense that they would not have obtained with the same production as before and the consumer we will say has one benefit in some added capacity I say he has a headache if charged with storage although it increases repressuring but assume he has some benefit, what he is doing, he is paying for everything he gets. The consumer has one thing and he pays for it and the others are getting something extra which they not only get paid for but they get the additional amount.

If you take that position it seems reasonable on the basis of benefits received that the oil industry should pay something. They are getting two benefits they did not have before, and they get money they could not have got

Argument by Mr. Fenerty.

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before and the dry gas industry has the privilege of paying for it just as they have paid for it before. If you take that comparison it seems to me that the oil industry is entitled to participate in these costs.

Now I am concerned in the oil industry's participation in the 50% we are talking^{about}. I think perhaps it is a perfectly good claim for participation by the gasoline industry in the 50% but I am not concerned as it is not a utility operation and as far as that end is concerned they can regulate it any way they see fit. I am not going to participate in the gasoline industry and they can well keep it but I am suggesting that^{if} the oil industry should participate in our 50% the oil industry and the gasoline industry get together or leave it to be regulated on the 80/20 which I think is none of my business.

MR. CHAMBERS: Pardon me, Mr. Fenerty. I am asking this for information. When you talk about oil industry had you anything specific to suggest to the Board as to what you have in mind ?

MR. FENERTY: The percentage.

MR. CHAMBERS: No, the mechanics of working it out. How are you going to charge it to them ?

MR. FENERTY: Oh yes, I am coming to that.

THE CHAIRMAN: Apart altogether from the fact that the oil industry is not before me on this Hearing.

MR. FENERTY: As a matter of fact I see my notes headed "Rate Base" and I think that is the place to deal with it. No, that is the operating cost. I was thinking for the moment of rate base. Well, you deal with it in the same way. That is our suggestion of course and I will elaborate on it, that the

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utility-as far as we are concerned we do not consider a non-utility operation. We do not invite the Board to say that the utility as a utility will handle the whole thing and then make certain charges that will take care of it to a non-utility, because that is making an order in the air. The Board has no power to enforce it. There is no way that I know of that the Royalite Company can be compelled to pay one cent if it does not want to, and I say we will have to deal with this on the basis of excluding that fraction of everything which is a non-utility operation, and fix an operating cost and charge and a figure for rate purposes on the basis of that fraction which is used and usable in the utility operation. That is the way we propose to deal with it.

I am getting a little ahead of myself there. I have it set out in sequence and will come back and perhaps repeat myself because of having said it here. Now I want to comment a moment before coming to rate base on the situation which I have perhaps already touched on.

I might give a reference here on the page I have been skipping. You will remember I said yesterday, I used a reference to meet the suggestion about this gasoline being vitally needed. I have the reference here. I see it was a reference by my friend Mr. Harvie at Page 410, Volume 5, I have it in quotations, referring to natural gas he said:

"Casing head natural gasoline is vitally needed by the Refineries".

I did not have the quotation before.

Now I have not worked that out as to what the proper allocation to the producer should be in these costs and I say if it is going to be allocated on the basis

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of the benefits received, it may well be that the benefits are greater than those received by the consumers, in that the consumers have always paid and will still have to pay for what they get and the producer will get paid for something that he did not get paid for before.

Now I want to emphasize here again, one of the benefits that the industries get in connection with the gasoline content of the wet gas.

As I understand the proposition before this Board, the Madison Company proposes to make a profit on all of its operation other than its wet gas operation. I may be wrong but that is the way I have analyzed the situation.

My understanding of the situation is that it proposes to handle all this gas on the volumetric method and on the basis they put forward at 15% at cost. There was a proposition involved whereby there would be the difference between 20 and 25% for service charges, and when you talk of service charge that is because I understand it is proposed in the future to make a normal charge for that.

Now first of all that gasoline content must have some value beyond a service charge or it would not be used or processed. The Royalite Company was not in that business before this division took place for the purpose of handling the cost. I know of no reason why the utility should expect and fight vigorously for a certain percentage of profit over and above income taxes in its utility operation and propose as a matter of fact I take it, of every day business to handle everything else at cost. I know of no reason for doing it. Unless in a controlled and directed company where it is held its cost was operating but I do not think it is suggested that

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a utility company should fight for profit on one part of its operation and say no profit on the other part.

Now the answer may be suggested that dry gas in this $7\frac{3}{4}$ cents was paying part of the cost before. I say that cannot be so because the 80/20 division as I understand it prevailed in the south end where there was no dry gas market and it was still 80% content paying the carrying charges, that is the 80% of the non gas market was carrying it at one part of the field. And consequently it is clear that the 80% of the gasoline content bore the carrying charges throughout, leaving the dry gas an increment just what it is and always has been.

One suggestion I did hear made was, I think it was made, that it be dealt with on the basis of the Madison getting a service charge. I have already pointed out the difficulties of that. That this Board is not going to regulate a non-utility operation and it is not going to regulate its service charge which it cannot compel payment of.

Would this utility business not be in a wrong position if the Royalite decided not to pay it and we got the whole thing on the shoulders of the consumer. The one way to deal with it is to deal with it and pay for it on the part that is used or useable. However if there was a disposition to deal with this service charge it has to be 100% because the service charge involves delivering 100% of the gas up to the absorption plant.

Now I am coming to the rate base. It follows from what I have said that if the 50% division on the carrying charges or operating costs or other division, that if I am

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right in my suggestion would have the same division in connection with the items going to make up the rate base.

We say as I have already indicated in advance of my notes that the proper approach is to include in the rate base 50% or whatever the fraction may be of the operating costs and of the values of the property for the particular purpose under consideration.

(Go to Page 7270)

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Argument by Mr. Fenerty.

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Now then, in subsection 2 of Section 49, it refers to what you are considering there, and it says;

"The values of any real or personal property for any of the purposes of this Act".

That is the purpose of this Act, it is just for dry gas.

Now, that permits the Madison company and the Royalite Company to deal with the non-utility operation, the gasoline operation, which the Act said, the gasoline content, and the Act says to exclude from consideration. It permits them to deal with that thing, and that this Board is not to deal with the non-utility operation on the basis of it not being a utility. They can deal with it on their own basis. They can get together by contract, and do with it what they please, because the only way you can enforce the payment to the utility is by a contract with the Royalite Company. You cannot make them pay because of an Order, as they are not a utility and not under regulation. You would have nothing to say with regard to them continuing their system of depreciation and putting it down in their books, as they can do what they please with their own operation. It is none of our business.

In other words, we say that they are entitled to it, and we are not entitled to interfere with it, and the only possible way we would be entitled to interfere or would want to interfere, is on the basis that if we participated in the gasoline profits. And if we are not entitled to, or not have anything to do with the gasoline content, or some part of it, and we are not interested in any part of that operation and as no one is willing to give us any part of the gasoline content, I see no logic, or rather I say, that in logic and reason we must be content to deal with regard to this rate base question solely on the used and usable portion

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relative to the dry gas industry, which might be 50% or 40%, or whatever might be determined by the Board.

I suggest again that if it is contemplated that the utility as such shall take over and shall charge in its base and its operating expenses all of its operations, its non-utility and its utility, it necessarily follows that the Board is regulating a non-utility operation. No escape from that. It just cannot be done.

It necessarily follows there that that is completely at variance with the used and usable principle. And I want to refer to an illustration pointed out by Mr. Hamilton. It is a convenient one to take because we have there a use, or an equal use, and I am referring now to the boiler capacity, where, as I understand it, we have three-quarters of the boiler capacity used in the gas utility operation, the absorption plant operation, and one-quarter in the dry gas operation.

Now, let us see what happens if the full value of that is included, assuming for a moment you could include it, on the basis of a utility operation, what happens if you include it.

Let us say that the Royalite Company ceases its absorption operation. Nobody has much fear of that, but let us say that the Royalite Company becomes practical or continues to be practical, let us say, perhaps that is a better way to put it, perhaps I could put it that way, and it says, "We are going to continue our absorption operation but we find that now we have got these boilers, we find it is not an economical operation and it suits us better to acquire some other boilers which would be better for our operation, with three-quarters of the capacity, and more efficient and use less fuel."

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And if for some reason or other they do not use it, we cannot make them do so, because they are not under your jurisdiction. Then what happens? We are left with the equipment, and it is in our rate base, and three-quarters of it is not used and not usable.

THE CHAIRMAN: And then you adjust the rate base, Mr. Fenerty.

MR. FENERTY: I beg your pardon?

THE CHAIRMAN: Then we adjust the rate base when that time comes.

MR. FENERTY: Oh well, I think the answer to that is if you are going to cut the rate base because it is not used or usable at that time, and if it not used or usable under The Utility Act, the way to deal with it is not to put it in there and then cut it, because it is not used or usable.

MR. CHAMBERS: Even if the wet gas goes to the market?

MR. FENERTY: What is that, Mr. Chambers?

MR. CHAMBERS: Even if the wet gasoline goes to the market?

MR. FENERTY: Pardon?

MR. CHAMBERS: Even if it goes to the city and is burned?

MR. FENERTY: I was not talking about that. I assumed that this three-quarters of the power plant is used entirely in connection with the absorption operation.

MR. STANLEY DAVIES: That is correct.

MR. FENERTY: That is the answer to that. I am only emphasizing the fact that it was not used or usable, and never could be or never was.

THE CHAIRMAN: A power plant is a public utility, so is

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a steam plant, Mr. Fenerty.

MR. FENERTY: Yes.

THE CHAIRMAN: And if they have a steam plant and an electric light plant and they are in service, they have to charge proper rates for it.

MR. FENERTY: Yes. Well, now, well all right. Is it suggested that we should now embark on an inquiry as to what would be a proper charge for steam to the Royalite Company in Turner Valley?

THE CHAIRMAN: Well I understand that that is already in the record. No one has quarrelled with it.

MR. FENERTY: I suggest that this inquiry has to do with gas and not a steam operation, and it is not on the agenda and was not advertised.

THE CHAIRMAN: But it is on the record somewhere. It is on the record, Mr. Fenerty, the cost of producing steam and the amount that the absorption plant pays for it. Then if the time comes when this public utility has assets which are neither used nor useful, then the rate base must be adjusted.

MR. FENERTY: Yes, but then you are getting into an inquiry as to the power operation.

THE CHAIRMAN: Yes, quite right.

MR. FENERTY: I say it is outside of the scope of this inquiry.

THE CHAIRMAN: Possibly you are right, but technically I could move into another Court Room and say, "I am now the Board of Public Utilities" and deal with that problem.

MR. FENERTY: I assume the logical thing to do, and I do not know whether the Madison Company even has the power, I have not examined this, and I do not know whether it has the power to engage in the power operation and to sell power. I

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do not know about that.

THE CHAIRMAN: Oh, I don't know, Mr. Fenerty. I used to practise law, you know, and when I incorporated a company I let the company do everything except banking and the business of a trust company, and I anticipate Mr. Chambers did the same thing if he incorporated the Madison Company.

MR. FENERTY: You would not do it now with a Dominion company. They keep you pretty strictly to your primary powers. I agree you could do it with a Provincial company. But there is no evidence that this company could engage in power operations, and I say it is outside the scope of this inquiry. I suggest the logical and the simple thing.....

THE CHAIRMAN: Mr. Fenerty, do not misunderstand me. I see your point quite clearly, but I see also the remedy for the situation if it occurs.

MR. FENERTY: That might be a fallacy in my argument, that when they cease to do those things then the rate could be revised.

THE CHAIRMAN: And if you then have that situation before you, then the boiler capacity and your power plant capacity have become obsolete to the extent that they cannot sell their products. That is called functional obsolescence.

MR. FENERTY: Yes, but let us see where that is going to lead us.

MR. HARVIE: Mr. Fenerty, do I understand that you suggest.....

MR. FENERTY: Just a minute, Mr. Harvie, while I put this down while I have it. Yes, Mr. Harvie?

MR. HARVIE: Do I understand that you suggest that the steam plant now owned by Madison is not a utility that can be dealt with under the Natural Gas Utilities Act?

Argument by Mr. Fenerty.

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MR. FENERTY: I say to the extent of one-quarter it is used and usable, and for the purposes of rate making, as distinguished from expropriation purposes, and under the provisions of the Act where you consider the thing for the particular purposes of the Act, that you have under consideration, it is logic and very sensible to deal with one-quarter of it for rate purposes. That is one of the things that differentiates between expropriation proceedings and rate purposes. It is one-quarter of it that is used and usable for rate purposes.

Now, I just thought of something more, in thinking of what I put down here. If we are going to embark on a power proposition by that company, and sell power and sell steam, I suggest it necessarily follows it should get its sole value out of the gasoline content of the gas. There is no reason for steam operation with some kind of a profit could not charge a reasonable charge for the gasoline content. You just get into these many ramifications when you go into this. I think the answer for the purposes of this Act now, is to get a dry gas rate, and a dry gas rate base, and not a steam or power operation or a gasoline operation.

THE CHAIRMAN: And supposing there was no absorption plant there at all?

MR. FENERTY: Yes?

THE CHAIRMAN: Would not Madison require steam and power to carry on its utility functions?

MR. FENERTY: I do not know what amount of power it would require, but my understanding is that three-quarters of its power is at present wholly used in the absorption operations, and the Valley Pipe Line, so that there might be some adjustment. You will perhaps more than likely be able to do that in another hearing.

Argument by Mr. Fenerty.

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THE CHAIRMAN: I think there is a remedy for that situation, Mr. Fenerty.

MR. FENERTY: Yes, there might be a remedy, and you might be able to meet that situation, but that is no reason for including it when it is not used or usable in the matters that we are inquiring into now.

THE CHAIRMAN: Yes. And again I say, supposing there was no absorption plant at all?

MR. FENERTY: Yes?

THE CHAIRMAN: Madison still would require the steam and power to carry out its functions for dry gas?

MR. FENERTY: Oh well, and I have no doubt that what they would do then would be to get a boiler of a smaller capacity and have a real economic operation.

THE CHAIRMAN: But let us assume that it is starting out for the first time and it is only putting up its buildings.

MR. FENERTY: Yes.

THE CHAIRMAN: And it needs power and it needs steam, the company needs both of those.

MR. FENERTY: Yes.

THE CHAIRMAN: Now, would you say that they should not be included in the rate base because it has nothing to do with the dry gas?

MR. FENERTY: I submit you are not going to put it into the rate base on the basis of 300 horsepower when you only need 100.

MR. CHAMBERS: The unit cost is smaller the bigger it is.

MR. FENERTY: Well, that is my argument. It seems logical to me that we should only include that portion which is used or usable, and we should only confine those things to that portion of the cost and that portion of the capital expenditures

Argument by Mr. Fenerty.

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which relate directly to the gas industry. Now, that is all I have to say on that point. That is the argument I have to make.

THE CHAIRMAN: Mr. Fenerty, I want to adjourn for about five minutes. I want to see Mr. Chambers about an entirely different matter.

MR. FENERTY: That will be very acceptable to me.

(At this juncture a short adjournment was taken).

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C-2-1 - 11.30 A.M.

Argument by Mr. Fenerty.

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(After a short adjournment)

MR. FENERTY: Now, Mr. Chairman, we come to the value for rate making purposes.

Here again I say that a different situation applies to old and new equipment, the value of which appears in the rate base.

So far as the new equipment is concerned I take it there can be not very much dispute as we have the figures, the costs, and there is no dispute about them, the dispute there being represented by this question of new B. A. equipment and whether it is considered on the basis of estimates or the basis of actual figures. That has been put before the Board for its consideration and the decision is with the Board.

But dealing with the rate base involving old equipment which appears in the rate, our suggestion is actual or historical cost, and, by the way, I believe there is some difference between those two, although I am not clear what it is, but the actual cost anyhow.

We agree that there are other methods, some of which are suited to particular purposes but we suggest that the legislature in enacting the Natural Gas Conservation Act, is it, -the Natural Gas Utilities Act, had in mind and indicated that it had in mind that historical costs should be used. Now following the able argument made by my friend, Mr. Steer, in which he indicated that there are certain objections to reproduction costs in the case of an era of falling prices and so on, perhaps this argument is surplusage, but it is an additional and supplementary argument and I feel it is clearly indicated, and I want to refer for a minute to Section 49 (2), and I am going to keep pretty close to this section

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and I am going to try to keep my friends pretty close to this section also throughout this Inquiry and I suggest that that section indicates that historical costs should be the basis of this Inquiry, - whatever it might be in some other Inquiry.

Now I think I am safe in saying that all the witnesses who dealt with the subject of depreciation and historical costs and who were questioned on the point, were unanimous that replacement costs could never exactly represent the true position without theoretically at least an almost daily revision because they change daily and that a valuation on the basis of replacement costs will necessarily provide either capital gains or losses-in an era of rising prices it is capital gain,-depending on the trend of the market.

And incidentally, with respect to capital gains, you will remember that Mr. Baker, in his submission as to the rate of return, advanced one reason for a substantial rate of return, a very substantial rate of return, and that was that the utility could make no capital gain and we have here a submission that we should have higher rates of return because the utility can have no capital gain and a submission that on the facts as they now exist, the rate should be fixed much higher in order to give the utility fairly substantial capital returns.

I have no objection to those arguments being made but I think I am entitled to point out that industries, - I mean it is good if you can get it but I do not think you can do that on the basis of what is "just and reasonable".

Now to go back though to the main point: Mr. Hamilton recognized the principle that in order to carry the theory out, replacement costs must be continually adjusted and he

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agreed on cross examination that the figures given by the witnesses for reproduction costs are now obsolete in view of the extensive revisions necessary to be made by the Board on account of the evidence given as to war taxes, sales taxes and customs returns. Mr. Hamilton's statement to that effect is found at Page 5347. I am referring to this 8% sales tax, the 10% and so on, that they are obsolete. The report is here but so far as its effect is concerned it is out of the window.

Now if that be so, the situation in so far as historical costs are concerned, that they are in fact affected by these day to day changes, the result I submit is, - and you will remember my friend, Mr. Chambers, cited cases, with which I will agree, that there must be the evidence to go on, it must be founded on evidence, and the situation is that today the only evidence we have that you can go on is the historical costs basis. The others are out of the window. That is all, and they have not been replaced. We closed this Inquiry without any efforts to replace them.

Now coming to this section 49 (2).

I am going to submit later, in dealing with depreciation, that the wording of 49 (2) is such that book depreciation should be that which should be considered by this Board. I do not want to elaborate on that at the moment but assuming that that argument is correct, that book depreciation is the fair basis, I say now then in dealing with costs that necessarily you must take historical costs because you cannot apply book depreciation to anything other than the figures it was applied to and those relate to historical costs.

If there is anything in my argument that

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this book depreciation should be taken, you have to take historical costs, because you cannot apply book depreciation to reproduction costs.

THE CHAIRMAN: Mr. Fenerty, let me put two cases to you, and I am now speaking of "book depreciation" and for simplicity we will take two companies with a capital of a thousand dollars each.

MR. FEN. TY: Yes.

THE CHAIRMAN: The one says "I am going to recover this capital before I start paying dividends".

MR. FENERTY: Yes.

THE CHAIRMAN: In ten years he has recovered his capital. The other man says "I am not interested in capital. I am going to pay dividends."

MR. FENERTY: Yes.

THE CHAIRMAN: At the end of ten years one has no book value, it is gone, while the other has still a thousand dollars.

MR. FENERTY: Yes.

THE CHAIRMAN: Both of them are coming under regulation for the first time, how do you suggest we build the rate base ?

MR. FENERTY: On my argument and on my contentions throughout this Inquiry I do not have to meet it. I submit that the Board is now emphasizing what I have tried to say from the beginning, that you may try to figure your depreciation in the way that it will do you the most good, but what you should have figured was what was the proper depreciation. You have either got your depreciation or you have not got it.

THE CHAIRMAN: You see the one man, the one man, paid dividends at the expense of depreciation.

MR. FENERTY: Yes.

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THE CHAIRMAN: And he still has his thousand dollars book value on his books.

MR. FENERTY: Yes, I realize that fact and I say it is quite falacious to say you have one set up for one purpose, which is quite proper. Either you have that depreciation or you have not got it. You have held out to the world that your assets have been depreciated in your annual statement. I know that accountants have been against me but I still cannot understand this theory that depreciation is governed by what you are seeking to accomplish rather than the incident of depreciation.

THE CHAIRMAN: Well then follow it up. The difference between those two men is this, that one has paid out a thousand dollars in dividends and he has his plant, while the other has his plant and he has a thousand dollars cash depreciation earned and put away.

MR. FENERTY: Yes.

THE CHAIRMAN: How do you fix the rate base under those conditions ?

MR. FENERTY: You cannot reconcile a thing where one man has paid out more profits than he should and the other has taken more depreciation than he should. You are asking me to reconcile two things, both of which are wrong.

MR. CHAMBERS: Which is the right one ?

MR. FENERTY: Which, to pay out more in dividends than the profits and depreciation should allow, I say that is wrong.

THE CHAIRMAN: Oh now, do not let us get into that, Mr. Fenerty.

The point you were mentioning was that the Board should take book values, or rather book depreciation.

MR. FENERTY: Yes.

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THE CHAIRMAN: Now if I do that in those two cases, I give one man a rate base of a thousand dollars and the other man has no rate base at all.

MR. FENERTY: Not if the depreciation taken is proper, what it should have been, you are going to have the same result.

THE CHAIRMAN: All right.

MR. FENERTY: And if they have taken an improper depreciation you cannot adjust it.

THE CHAIRMAN: And what is the proper way ?

MR. FENERTY: And the same with the profits.

MR. HARVIE: Is observed depreciation proper then ?

THE CHAIRMAN: I am asking Mr. Fenerty which is proper.

MR. FENERTY: I will come to observed depreciation in dealing with depreciation later but at the moment I am going to try to stick to this because I might get off in a side alley and I might say the wrong thing.

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MR. HARVIE: I am sorry but I think, Mr. Chairman, Mr. Fenerty did not hear your question.

THE CHAIRMAN: My question is: What is the proper depreciation?

MR. FENERTY: Oh, what is proper depreciation.

THE CHAIRMAN: It is not necessarily what is in the book.

MR. FENERTY: All I am going to say is this, the reports are full of that question particularly with relation to income tax and if counsel and court have spent days and weeks and months on the question of what is proper depreciation, that is proper in the circumstances of that particular case, all I am saying is it is not proper, when in the same circumstances, it is not proper because one man sought to accomplish to do one thing and that it is proper to do it in an entirely different way to accomplish something else. There is only only one proper depreciation if there is one set of facts. That is all I am saying. I know that limits the scope of our friends, the accountants, but I think it is proper.

THE CHAIRMAN: In dealing with taxation matters appellants come before me and they say: "Our building cost so much money. The income tax people allow us to depreciate it at a certain rate, depending on whether it is brick, stone or frame." I am not interested in what the income tax authorities allow for the purpose of fixing a valuation for taxation.

MR. FENERTY: There is a viewpoint. I can appreciate it and perhaps this illustration is against myself but I can give you one illustration where we have what I call theoretical depreciation. Take a well with a high cost and a small output. The income tax authorities allow you to fix a percentage of that reduction by way of depreciation. Take another well

Argument by Mr. Fenerty.

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with a low cost and a high output and they still get the same percentage of depreciation. One might depreciate in a year and the other might never depreciate.

MR. HARVIE: That is not my interpretation of the Income Tax Act.

MR. FENERTY: That is statutory depreciation, but insofar as it is not regulated by statute I am presently going to refer to a discussion between my friend Mr. Chambers and Mr. Hamilton, where they agreed between them that what the Income Tax Act allows, that is a statutory one, was generally a fair test of reasonableness. It is fair and reasonable. I am going to adopt that. I am going to refer to that citation.

However I want to come at the moment to this argument of Section 49(2) - where was I?

THE CHAIRMAN: You were suggesting that the effect of 49(2) was that I should take the book depreciation as a measure to employ in fixing a rate.

MR. FENERTY: Yes. I did not intend to come to the depreciation end of it. I suggest just at the moment that 49(2), that if my arguments on depreciation should turn out to be correct or meet the views of the Board, that is that it contemplates book depreciation and I am not now going to make that argument, but if it does, it necessarily follows that you must take the book value in order to apply book depreciation. That was the argument I was making at the moment. Now Mr. Zinder agrees that normally original cost is the logical and sound basis for accruing depreciation, at pages 3995 and 3996 in Volume 51. But to be quite fair, as Mr. McDonald pointed out, he suggested that under the circumstances of this case that did not settle the thing.

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It was just a superficial view for consideration.

Section 49(2) makes what is just and reasonable the only test in arriving at a fair value, and the Board may disregard price, book value or replacement value. Now if that be so I suggest it necessarily follows that the legislature has discarded the theory of regulation for the first time. The Legislature has done it. It has thrown out that theory because it says you consider the elements having to do with a company that is coming under regulation for the first time but you cannot consider in arriving at a fair value what they have done. Now to say that the Act says you consider all these things, even though it is coming under regulation for the first time and then to attempt to say that you cannot consider them because they are coming under regulation for the first time is arguing in a complete circle. It is a complete negation of the Act. Then with all due respect to my friend Mr. Chambers, that is exactly what he said when he referred to section 49(2) and said: "Notwithstanding that the only principle you can go on as to the value of this property was on an expropriation basis. In other words, I submit and I say it a little later on in my brief but I will say it now, he has invited a comparison between the decisions of eminent English jurists in other days and under other circumstances, a comparison between the tests that they say can or should be used under those circumstances with the ones that can and should be used under this Act by inviting you to discard the Act and take only what they say. I say it is completely idle to say you must consider those decisions and when the Act says that you can consider other things. That is arguing in a circle. Well all right. Now

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I suggest that 49(2) has excluded the doctrine of regulation for the first time, in that it provides for a consideration of all the factors that you can consider if a company had already been regulated. If you can consider them notwithstanding the fact it is coming under regulation for the first time, then nobody could put up the argument that you cannot consider them because they are coming under regulation for the first time. It just does not make sense. I do suggest, as Mr. Steer suggested more than once, that in view of the fact that we have a wholly integrated operation in the past and we have had figures, not fixed by the Board but which we will say pursuant to agreement was given the blessing of the Board, it is a little exaggeration to say it is an entirely new operation and that we come then under the doctrine of regulation for the first time. So far as the $7\frac{3}{4}$ cents are concerned, I do not think anybody can say that that has not been regulated with the blessing of the Board at least if not by the direct requirements of the Board.

THE CHAIRMAN: Of course on the $7\frac{3}{4}$ cent rate, I meant to mention it yesterday when Mr. Steer was here, the Board had no jurisdiction to interfere with that $7\frac{3}{4}$ cent rate until after the amendment of 1942. Prior to that the Board could only deal with it on the complaint of one or other of the affected parties.

MR. FENERTY: Yes.

THE CHAIRMAN: That section was in force at the last Hearing between the Gas Company and the City of Calgary but it seemed to me from reading the record that they carefully avoided touching it, both of them, probably for good and sufficient reasons, I do not know.

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MR. FENERTY: I am not in any way suggesting the Board should intervene. All I say is that when they seek to obtain the approval of something they agree to between themselves it is stretching the thing a little bit to say that there has not been something subject to utility usage and regulation. That is as far as I am going. I quite realize that they were responsible and I am not founding any argument on the $7\frac{3}{4}$ cents being fixed by the Board. But I am founding an argument on the fact that it does not lie in the mouth of the Royalite Company to say that that part of it was not under regulation.

Now I suggest to you further in that matter of regulation and so on and of public service, I suggest to you that the reason for the inclusion of the old Madison installations in the rate base as distinguished from the G.O.P. and the B.A. Oil old erections, which I say should be excluded because they were a going concern and in operation and wholly related to other industries. The reason for their inclusion is that Royalite claimed that it was part of a dry gas operation and a dedication to the public for the dedication and regulation of the industry. You see they are making all the arguments which would be made on one aspect founded on the relationship of the supply of gas, the supplying of the utility to a public utility and all of those benefits but when it comes to the matter of the incidence that flow from that they say: "We are coming under regulation for the first time. We start out as if we had never had anything to do with this before."

I see the real difficulty in law

THE CHAIRMAN: They have always been under regulation

Argument by Mr. Fenerty.

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but they were never regulated.

MR. FENERTY: Perhaps again I might stop two minutes earlier. I have another point again.

THE CHAIRMAN: All right, Mr. Fenerty. 2 o'clock.

(At this stage the Hearing was adjourned until 2 P.M.)

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2 P.M. SESSION

I find Mr. Chambers' argument as to the principles that must be applied in order to determine fair value very interesting. He recognized, as well as we all must recognize, that Section 49(2) of the Act cannot be entirely ignored, and I submit what should have been done, and I submit with all due deference that what Mr. Chambers did not do is to treat that section as embodying various matters, any one of which or all of them might be, and in some cases perhaps should be, not all of them should be but any one of them might be, and any one of them in some cases should be, considered and treated as a yardstick or guide in order to arrive at those values. I pointed out a while ago, when I got on to another matter, that my learned friend quoted English authorities for the most part based on condemnation proceedings or expropriation proceedings, and I am free to confess in taking objection to those authorities I did not realize the full force of the arguments that might have been advanced, and which have been advanced by Mr. Steer showing what is the fallacy of using those arguments.

I have a couple of others to add on my own, though.

As I understood those arguments fol-

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the English authorities dealing with other facts and common law, that what has been earned, the depreciation reserve created has no bearing on the situation, and cannot be taken into consideration, otherwise you would be acting arbitrarily. All I can say is that you can take it into consideration, and surely you cannot be acting arbitrarily if you take into consideration something that the Act says you can do. It is a question whether it should be taken into consideration under the circumstances of this particular case for one purpose only, in order to arrive at a fair value, a just and equitable adjustment.

I also understood my friend, Mr. Chambers, to say, and I think that is correct in view of the way that Mr. Steer dealt with it also, that the conversion or compulsory taking applies to fixing values for rate making purposes. I submit that is not right, and I support Mr. Steer in his suggestion that the texts and the authorities emphasize that the contrary is the real position.

I suggest that the cases and the texts have repeatedly emphasized the difference.

Now, that suggestion that you should take the tests which are applied for condemnation proceedings or compulsory taking to values for rate making purposes, seems to me to involve a complete contradiction. In other words, the purpose is that what is to be paid to the company on the rate making basis where the company retains ownership of the assets, is to be exactly the same as where the company sells those assets or they are acquired by the other parties.

Now, I take it my friend would be the first to protest vigorously if we suggested that on the completion of amortization, that on the amortization of the costs, we are entitled to own the assets. I can imagine what he would

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say. But he says we must pay on the basis that we own them and that the company will retain them. That is the thing if he is going to treat compulsory basis the same as for fixing rates.

Now, our case on valuations is simply this that we have no evidence now before this Court on that, and that the values cannot be fixed on anything other than historical cost, that is on the circumstances and facts of this particular case which have been reviewed at length, and that reasons of natural justice require those figures to be used in any event.

Now, I come to the question of depreciation. As I take it, the Board has assumed in the case of the old construction, what is past, and those items of the old construction which properly appear in the rate base, we say that for those that book depreciation is the governing factor. Here again I wish to refer to Section 49(2), you will remember I founded an argument on costs being taken because I said 49(2) required book depreciation to , and now I am coming to the elaboration of that argument. That section says,-

"Without restricting the generality of the foregoing the Board in fixing such prices or values shall determine the just and reasonable allowance for depreciation, and in so doing may take into account depreciation already taken by the owner or any antecedent owner of such property."

Now, it does not say the antecedent public utility owner, nor the antecedent owner that has been regulated under Public Utility regulations. It, in effect, says any owner, and in effect it says the Royalite Company may take

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into account in this case the depreciation already taken by the owner. That is the antecedent owner. That is as good a way of describing the Royalite Company as I know in the general wording of the statute.

MR. HARVIE: There is a definition of the word "owner".

MR. FENERTY: It does not confine it to the public utility.

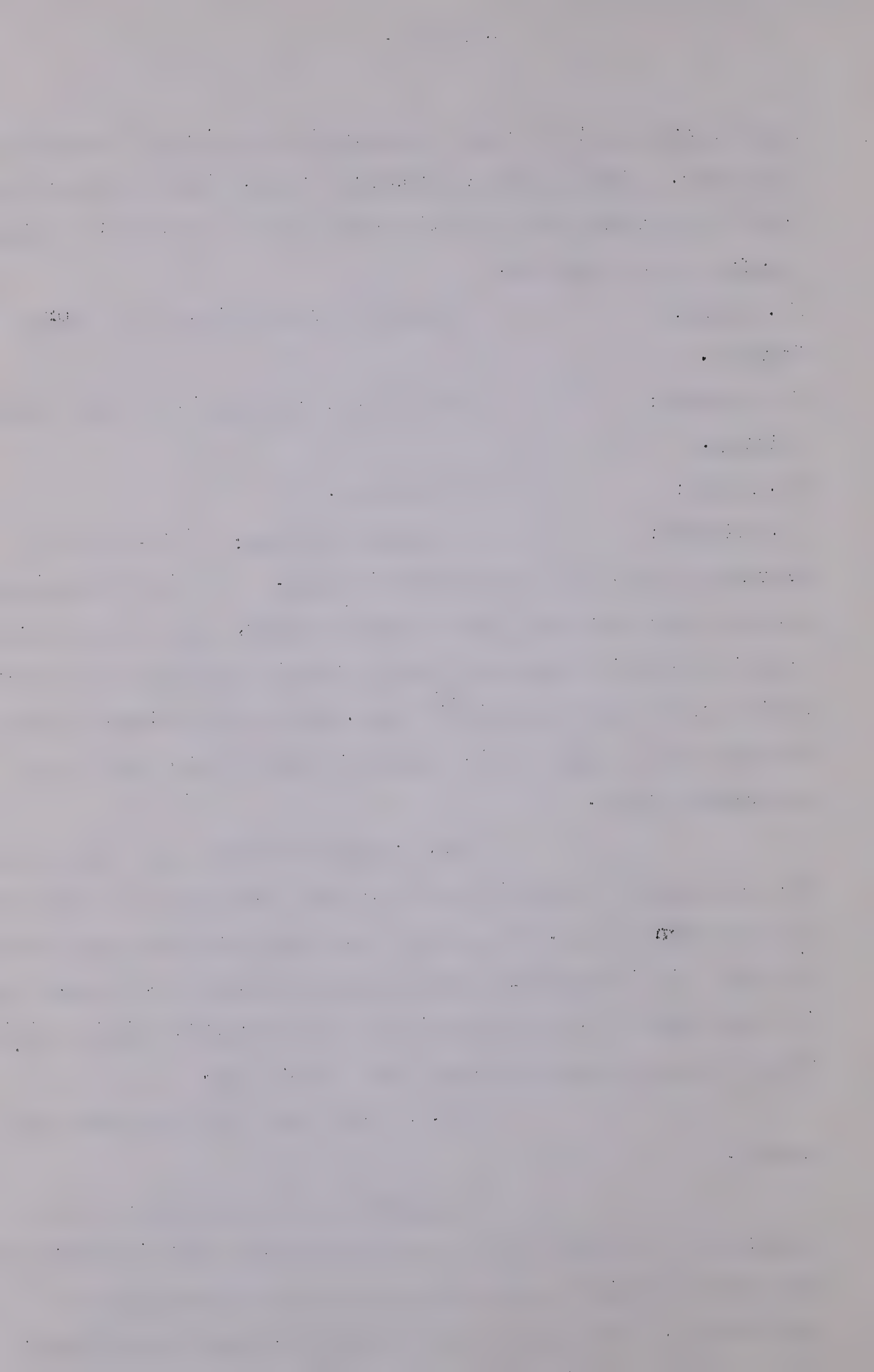
MR. HARVIE: I think so.

MR. FENERTY: I do not think so. If it does my argument fails. I do not think it does. I think it includes people other than the public utility owner, and I quite agree that if the prior owner has been a public utility that necessarily would have to apply^{to} it then, but at the moment I suggest now that it is depreciation already taken by an owner or an antecedent owner.

Now, I suggest to you that those are not apt words to describe what has been allowed by a Board to an antecedent owner. It is not something that has been given to them; it is something that they have taken. I suggest that if that meant it to be confined to an antecedent public utility owner it would have been very easy to say so.

Now, I just have lost the thread for a moment.

I suggest to you that there is an elementary principle that a statute will be given interpretation so that there will be some meaning to it and is capable of application. The question was put to Mr. Hamilton in cross-examination that if whether or not we had the strongest possible case here for the application of those rules, the consideration of the depreciation taken by the antecedent owner, where we have



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a wholly owned subsidiary with the same equipment used by the previous owner, and operating in the same field. My friend, Mr. Hamilton, after some cogitation, said he could think of a stronger case than that, namely, one where the parent was a public utility at the time.

Now, I say again if that section was meant to apply to a public utility owner, or if either of its implications were not to affect companies other than public utilities, the Legislature would have said so.

Now, if I am right in that, that when we refer to something taken by the antecedent owner as applying to others than public utilities, then I submit that we have here the strongest possible case where that yardstick could be used, where we have a wholly owned subsidiary with the same assets and the same field that it is operating. And I say if we do not apply them, and it is not a proper case to apply that yardstick in the strongest case, it follows that it never can be applied, and we have rendered the section nugatory.

Now, I say again that whether or not the depreciation that has been taken is fair and reasonable may be a proper matter of discussion, and I want to refer again to a discussion I just mentioned incidentally between Mr. Chambers and Mr. Hamilton at page 3688, Volume 47, which I interpret as an inquiry by Mr. Chambers. Yes, I have it in quotations as being the exact words. As being a inquiry by Mr. Chambers as to what the Income Tax Department allows, as to whether what the Income Tax Department allowed is a fair test of reasonableness, and the assent of Mr. Hamilton to that. Well, I am disposed to go along with them. If what the Income Tax Department allows is a fair test of reasonableness, and if there is no evidence that in this case it was unreasonable, then it

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follows it meets the exact definition of what is reasonable depreciation to be taken here, just what they did take. I suggest again that we are, as I say, in agreement that what the Income Tax Department allows is a fair test of reasonableness. And I suggest if by reason of that rate of depreciation the company has lessened its obligations to the country as a whole, and properly so, and that country as a whole also includes the gas consumers, and it attempts to retain the advantages, probably I should not say advantages, attempts to retain that right, I will say, it should not adopt or should not be permitted to adopt or attempt to adopt another basis for the purpose of increasing its revenues, and at the same time necessarily increasing the burdens and obligations of the consumers.

You mentioned this question, Mr. Chairman, what might be done where depreciation had not been taken on a proper basis. I do have a reference to that as a matter of fact, and I find that in the Hope case, the Commission found that Hope did not follow sound depreciation practices, and I have an analysis of what they say there about regulations the first time. They are applying that doctrine and considering depreciation under that doctrine in a case where there was regulation for the first time, as a matter of fact, but where proper depreciation had not been taken.

I would invite the consideration of this Board to the suggestions found in the Commission Report, reported in F.P. Commission Opinion 76, that is the Hope Natural Gas case in 1942, where it went before the Commission, and it was held that where a company has established certain claims before another tribunal, and I am referring at the moment to such things as book depreciation, that it will not be permitted

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to reverse this position in order to gain an advantage before the Commission. Now, I say in the absence of any evidence of depreciation taken which may be considered essentially fair and reasonable, that that is the position, and that it should not be permitted to reverse that position.

I suggest again, and I know I am getting involved in this question of dividends at the expense of reserves, and reserves at the expense of dividends, and I suggest again in the successful operation where the depreciation has been earned and is in fact represented as it must be in a successful operation by cash in the company's corporate pocket, I do not know whether Mr. Hamilton agrees entirely with regard to this, but I know of other accountants who say that that is the position.

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And whether either that cash in its pocket or if you want to take it the payment for the assets that have been used has been obtained necessarily in part at the expense of the gas field and I am referring to the dissipation of gas over a long period, resulting in a profit to the Company and in turn necessarily resulted in an increased cost to the consumer, because of operation and shortness of the life of the field. That is another reason why no volte face should be permitted at this time. The Company should not be permitted to make a gain at the expense of the field and then reverse the situation when he comes up here and make another gain at the expense of the consumer.

Now following calculations on the basis of book depreciation, our submission is that depreciation, the next choice is depreciation on a throughput basis with reserves calculated on the actual throughput to December 31st, 1943 with adjustments for each year with reserves as they now exist on what I call the guaranteed basis. I am coming to what I mean by guaranteed basis in a minute and that these figures should of course be on the wet gas throughput because a lot of that dry gas resulting from wet gas was blown into the air and does not appear in the consumers figures at all.

If a basis of historical costs and book depreciation is adopted, depreciation from January 1st, 1944 and depreciation on new construction should, it is submitted, be calculated on the basis of throughput depreciation based on a reserve as finally calculated on the basis of the guaranteed throughput. That is a throughput for the future.

Now that brings me to the rate of return. I want to discuss for a moment what I suggested in the way of the

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guaranteed throughput. In other words we are suggesting a computation of what will go through on the basis that is in effect a guarantee that has a field life or throughput sufficiently conservative to in effect guarantee the utility from loss.

We say of course and there is a catch to that, we would say that would be compensation in the way of reduction of return method. It is obvious of course that the shorter amortization period protects the utility from possible overestimating of gas available and from possible hazards of latter years involved in the discovery of new fields and other incidents and in short we say that protects the utility from all the hazards that it now appears to fear, and the hazards it now uses as the basis for a higher rate of return than would be the case in the case of risk free industry.

THE CHAIRMAN: What about the hazards you yourself mentioned, the possibility of the Princess field ?

MR. FENERTY: That is the reason why we get the thing paid off before these hazards materialize. Once you get half or three-quarters paid off you do not worry much about it. That is the kind of thing I am talking about. If we make it reasonably short we in effect guarantee them.

On that basis the industry is protected by a quick return of a substantial part of its investment and here is the point that should be given some consideration. The oil operator gets some benefit in that he is protected if the fixed charges decrease rather quicker by reduction of the rate base. In that situation it may be possible a little later where his production is decreasing, where he is getting problems of his own, to allow him something for his gas because we have got part of the rate base out of the way and part of the return on the rate base out

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of the way and it may be possible and I would say probable that you might effect such reduction still allowing the utility a proper rate on its rate base as exists from time to time to give something more to the well owner to take care of his position in later years and still give something by way of reduction of the rate to the consumer.

I say that once the industry submits that it must be allowed a rate of return based on the risks taken and that rate must be paid by the consumer it necessarily follows that the consumer must be permitted to reduce that risk. You cannot complain of the risk and ask for a higher rate base without allowing the consumer to eliminate that risk, and we say if you complain of that risk we will allow your complaint and if you have a quick return on the money you necessarily then have given them a guaranteed throughput, you set the rate of increase on the basis of elimination of most of the risk.

My friend Mr. Harvie said the same thing although he did not follow out the consequences at Page 422. He says:

"It is a sound way to eliminate the risk in the early years".

Mr. McCutchin said at Page 229:

"A short period of amortization is reasonable".

Now assuming that is logical, we have a corollary with it and the corollary of the proposition advanced by the industry is that the risks assumed justify a higher rate of return is that the elimination of those risks involves the corresponding reduction in rates of return with the result of a comparatively low rate of return. They cannot have it both ways and they cannot object to the elimination of the risk

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they complain of.

Now in considering apart from this question of risk free rates, there are other things that should be considered. One is the matter I indicated a while ago. That is we have the cheapest money we have had in some ninety years.

I say the rate to be fair at that time must take into consideration the situation as it exists at this time and if money rates are cut in half at this time and some other things then effect must be given to that.

I suppose that every investor in securities in so far as securities other than common shares are concerned has found that those companies, the soundest ones as he thought, had been refinanced and that his returns are almost cut in half. I suppose that one of our problems to be treated today is that we have many people who after a long and useful life thought they could retire on their income and have found that it is cut in half.

I do not know of any principle which exempts a public utility from the incidence of the period through which it operates and imposes burdens on other companies but exempt the private utility. I do not know of any. I have not found any in the text. We are living in the times when there are reduced returns to others.

Now then a short amortization period necessarily increases the amount annually required for amortization.

On the other hand it reduces the rates of return and we submit it is possible and should be possible to correlate those two so that the net amount required does not vary appreciably. There is less rate of return and the risk is eliminated. There is a short amortization period and the

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consumer benefits.

I say incidentally the fact that there will be the saving of a substantial amount by way of income tax which the industry would otherwise be assessed and which the industry contends we should pay is no valid objection to the matter being dealt with in the way it may be at the expense of the Dominion Government, but I submit that is no objection.

We have another situation and I come to it in the matter of bonds. Where the financing adopted by these companies imposes a burden by way of income tax on the consumer that would not have been imposed had financing in part by way of bonds been indulged in. That may be a proper burden to impose and I do not suggest any other financing should be indulged in. That may be a proper financing by imposing the burden on the consumer but here we have a method that eliminates the things they complain of, the risks they fear and at the same time relieves the consumer of some burden of income tax. If we can find something in this Inquiry by which somebody can profit and the Dominion Government loses we should take advantage of it because the Dominion Government will get the benefit of other proposals.

Now I am going to suggest that an interest rate not a pure interest rate but something more akin to that than has been suggested by anyone at this Inquiry so far is justified on other grounds besides elimination of risk because I have got to realize that no matter how you go in you do not go in without risk. It is elementary that the quicker you cut down the rate base the less chance of risk there is.

Here is what I am going to suggest and I will suggest one of the things demonstrated by you, Mr. Chairman,

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when you questioned Mr. Baker at Page 2956 (Volume 38) and I say this is the reason that a rate of return on interest might be cut. In answer to your question Mr. Baker intimated that securities, various securities my friends were talking about in going concerns to yield $9\frac{1}{2}\%$ above income, because they would pay at least \$215.00 for par value shares of \$100.00. Now both Mr. Harvie and Mr. McDonald, and I am not sure about Mr. Chambers, in making their arguments about that said, - yes I think Mr. Chambers referred to rate of return on investment in other industrial securities. Let us consider what is being taken over here. They were not starting a new undertaking, building up something which would make the securities worth double. They were taking over an industry protected by the Public Utilities Act. They were taking over a successful industry firmly established and in business for a long period of years. If they are going to talk about what they could receive from securities in other established and successful industries they have got to talk about what they would pay for shares in this concern, assuming it was not a wholly owned subsidiary and as if it were an independent company and if it were going to earn $9\frac{1}{2}\%$ you would find their money would go just half as far there. That the securities they would buy would produce just less than half of $9\frac{1}{2}\%$.

Now I say there is one other feature in which I say that comparison is entirely inaccurate. Those companies are earning their income on their book investment and the balance of their investment after they have taken whatever depreciation they have taken through book depreciation.

I think perhaps for the purposes of argument we can assume in these days of high taxation those companies

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have taken such depreciation as they feel is reasonable and proper and as the income tax authorities realize is proper and reasonable and possibly allow.

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And I would be interested in knowing what the situation would be had those tests been applied to the Royalite operation and the depreciations that the Royalite had taken, the book depreciation and the residue value on the books, with reference to it. I suggest to you if you compare like with like, - I do not know, there may be a possibility on these figures, with the assets largely depreciated of a rate of return of $9\frac{1}{2}\%$ and I suggest on that basis their figures would be substantially below $9\frac{1}{2}\%$, they might well be cut in half. You must take it on the realistic basis, on the actual facts, if you take it in comparison with outside industry all the way through.

Now that brings me to the matter of financing through bonds.

It is recognized, of course, that this Board cannot compel the Royalite Company to accept bonds but it is submitted in the case of a wholly owned subsidiary it can and it should allow the wholly owned subsidiary a rate base on sound financing and one which will not have the effect, the necessary effect, of transferring income tax obligations to the customer.

Now Mr. Baker said that most public utilities are well suited to bond financing. That is at page 2951.

He said that a great many are financed that way, Page 2952.

But he said that this was not a suitable undertaking to finance that way because of the hazards involved. Now if the ordinary utility undertaking is suitable for financing by bond issue, and many are, and this one was not because of the hazards, if we have largely removed those hazards, it necessarily

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follows it now becomes a suitable utility for financing in that method.

Mr. Hamilton agreed that that was sound financing but I think, yes, no, I have not got that reference here and I will leave that at the moment.

Now it will be remembered that Dr. Stewart said that the method of financing should be left to the Company but he also said that in fixing the rate the Board should proceed as if the financing had been done in the cheapest way and if financing, on the basis of sound financing, had been adopted. That is at Pages 4506 to 4510.

Now I think I was right in that, that Mr. Hamilton said that that would be right, yes, that it was a legitimate and proper method of financing and I suggest that that is undoubtedly the method of financing that the Madison Company would have adopted if it had not been a public utility and was seeking to decrease its own expenses in connection with the financing, particularly where its bond interest would have been allowed for income purposes as an operating expense; in other words, if the Madison Company was not concerned with the passing on of this income tax obligation to the shareholders and was not concerned with the Royalite Company escaping that income tax obligation, it would have financed through a bond issue and we must treat it in the same position as if it had done so. I say that we must treat it as if the Madison Company had financed on the basis of the most advantageous operation for the Madison Company and the Madison Company alone. It is true that might have increased the expenses of the Royalite Company in that the bond interest that the Royalite Company got was income and revenue to that Company and it could not have

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been passed on to the consumer because the Royalite Company is not a public utility, but I say that we should treat Madison as if it had financed in the way it would have financed if it was an independent Company and as if the system of financing did not take into consideration the passing of that on.

Now somebody, in talking about that argument, pointed out the expense of handling bonds and selling bonds. My recollection is that the expense of handling and selling shares is much greater than that of selling bonds. In fact the Board recognizes that up to 25%.

THE CHAIRMAN: No, not with issues of this kind.

MR. FENERTY: 20%. I have not had one lately.

THE CHAIRMAN: Not in issues of this kind.

MR. FENERTY: No, but it is recognized as an expense.

THE CHAIRMAN: In selling speculative issues I allow 25%.

MR. FENERTY: I say, why should we refer to the expense of handling bonds as the reason for adopting a share basis? Surely it will be conceded that the expense of selling shares would be as great, if not greater than the expense of selling bonds and all I am saying at the moment is that it is not an argument against selling bonds.

Now working capital.

This is a minor matter and I am not too greatly concerned with it but I think there are some things to be said about it.

Oh yes, there is something I left out that I want to mention here, that Mr. Davies now calls to my attention.

There has been some emphasis placed on the negotiations between the City of Calgary and the Gas Company resulting in a reduction in the price of gas, down to its present

price. I want to point out that so far as we know, and I think it is true, that the only matter discussed at that time, or rather let me put it this way, that the rate of return was not a subject matter of discussion in that discussion and in the view of the city authorities that is a matter which can only be discussed as part of a general hearing involving the rate base and surplus earnings, as well as the rate of return, and I think I should point out now so that there will be no question about it any time in the future, that if and when such a rate hearing is held in connection with the Company's position, and that will be before another Board, and when and if it is ascertained that the Gas Company has a surplus of earnings as the result of the rates allowed, our position is that those earnings must necessarily go to a reduction of the rate base. We might as well understand one another right now.

All right, now working capital:

Mr. Hamilton prepared some very excellent graphs and gave some very excellent testimony as to what we suggest is legitimate financing in the shape of temporary borrowings, where the money is required for a short period only.

I say that it is obvious that if the company is concerned with the best of terms which it can obtain for its own benefit, - not on the basis of the rate fixed by the Board or the basis of all it can earn anyhow, - it is going to borrow where it can borrow at the lowest possible expense to itself.

Due to the incidents of the operation, there is a deficit of money for a short period and a surplus for the next period following.

If the principle of adding that to the rate base and getting a rate of return for it for the entire year,

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while only needed for a short period, were adopted, there may be a reason for not borrowing temporarily, but I do submit that in fixing figures this Board should consider what that Company should do and what would be proper financing if it did not have that object in view.

THE CHAIRMAN: You will agree, Mr. Fenerty, that I cannot tell them that they must do it that way ?

MR. FENERTY: Pardon ?

THE CHAIRMAN: That I cannot tell them that they must do it that way.

MR. FENERTY: No, I am not saying that they must do it. I am simply saying that you should proceed as if they had done that, if that is a proper case for it.

THE CHAIRMAN: And if they borrow money from the bank at 5% for the purposes of working capital, might they not be entitled to some reward for pledging their own credit to furnish the money to run an utility for the benefit of the public ?

MR. FENERTY: Might they not, let me get that again.

THE CHAIRMAN: Are they not entitled to some reward for pledging their own credit at the bank for the purpose of raising working capital ?

MR. FENERTY: You are saying that they pledge their own credit. All I can say is that they pledge what they are going to get from the customer during the next month. If that is "pledging their own credit", that is not the way it appeals to me. They can borrow it because they can say they will have it coming in during the next month.

THE CHAIRMAN: I know when I pledge my credit at the bank it keeps me worried until the pledge is redeemed.

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MR. FENERTY: But I say they are only pledging the money which is coming from the customer the next month. That is what they are pledging to the bank.

THE CHAIRMAN: And I am just wondering whether that is a proper way to look at it.

MR. FENERTY: It is the best argument I can think of at the moment, and the suggestion, I submit, is also a sound one, and there is no valid objection to it.

Now I want to refer for a moment to this:

Many of us here I think have had the pleasure or otherwise of appearing before Boards in connection with Excess Profits' Adjustments where we have had applications on behalf of an industry that was seeking relief from the Excess Profits based on the four year earnings, 1936 to 1939, is it not, and we have proceeded under that section and asked for relief because due to one circumstance or another, such as the seasonal nature of operations, and that is akin to this, the amount of capital employed was not a fair criterion of the business done and consequently you should base the allowance on the amount of capital employed and frequently and in many of the cases that was based on the fact that instead of capital being employed that it has been found to be sound business to borrow temporarily. I am referring for instance to the coal business where they have seasonal operations, they borrow temporarily and so on, and reduce their expenses in that way and I suggest that that method of financing has been invariably recognized by the Board and given effect to in the allowances which have been made out of all proportion to the actual capital employed because they were using temporary borrowings instead of capital.

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Then you take public utilities,- while they have been using capital throughout the year, they can borrow at a nominal figure. Here we say they can do that because they have the credit of these people who are using gas, and the borrowing is for a short period only.

Now I think it is of some importance to consider that. It is not a big item but it is in the rate base and I want again and this is perhaps self-evident, but I want to state it anyway because I like the way it is here, and I want to state it:

That their allowance by way of return on a fair rate base, becomes an exorbitant return when applied to a rate base increased beyond what would be the normal and legitimate investment of a non-utility company.

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Can anybody doubt if this was a non-utility company that it would not borrow the money, if it was not going to get interest on something on a rate base indefinitely. It would just go down to the bank on Monday morning just as all business does. I suggest the probably corollary to that is that nothing should be included in the rate base that would not be included in ordinary legitimate financing merely because somebody pays for it.

Now I want to touch on one other subject that is not of very great importance but I would like to comment on it, that is the question of charges. I am referring now to an item of approximately one quarter of a million dollars charged by the Royalite Company to operating expense, which Mr. Hamilton in his submission says might properly be, and I think coming under regulation for the first time he suggests it should now be charged to capital. Now we might have some disagreement as to whether or not depreciation can vary with the circumstances but I am going to suggest to this Board that they have a place here where there can be no variation due to the results thought to be obtained; that whether a thing is a capital charge or an operating expense does not depend in any way, shape or form on the benefits received from the charge by the things sought to be accomplished. It depends on the nature of the operation which results in that charge being made. It is either an operating charge or a capital charge and I do not care what you are looking for. And if it is a proper operating charge it cannot be a proper capital charge. It cannot be an operating charge, I submit, in one set of circumstances and a capital charge in another. It is either one thing or the

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other and I submit to this Board that the best judge of whether these charges were proper operating charges are the officers of the Royalite Company. They made those charges in good faith. It is a happy result that that did result in some saving of income tax, than if they had been capital charges. But they made them that way and they were entitled to that saving in income tax. But when the suggestion is made that we should now reverse their judgment, at least without any evidence on the part of those who made them; and why they should be reversed with no evidence at all from any practical operator, I suggest that is entirely wrong. Those charges as far as we know are being retained there for other purposes but they are operating charges and presumably they are considered proper. I am content to agree with the Royalite Company on that thing at least, they were proper charges and leave them there.

Then I am coming at last to competitive fuel. I think my associates and certainly myself had the disposition at the outset of this Inquiry to feel that this item, "competitive fuels", while included in the Agenda was not a proper subject matter for the consideration of this Board, because we were dealing with prices of fuels in Calgary and we thought that it would be more properly a subject of inquiry before the Public Utility Board when we were dealing with gas in Calgary and competitive fuels in Calgary, not in Turner Valley. But I have to agree, whether our ideas were sound or not, that the result is of the utmost value. My friend Mr. McDonald referred to some analysis made by Mr. Zinder and some superficial, extraneous superficial comments by Mr. Ralph Davis about coal and gas. I invite

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this Board to consider what I say is the only real evidence before you and that is the exhaustive analysis made by Mr. Stanley Davies and in this he was supported by data which was either not available or not known, or not produced by anybody else and which I say and submit, and in this I think we are borne out by Mr. Zinder, that coal is competitive now in one branch. I am coming to what Mr. Zinder said about that branch in a minute. It is competitive in at least one branch, and I am referring of course to the manufacturing end. Now I say that the results shown in the statement put in as an Exhibit and proved by Mr. Davies as to prices of coal and the results by various efficiencies and his examinations of the efficiencies as indicated by his own experience in hospital operations and his comparison as between two schools of exactly the same construction, one burning coal and one gas, with practically equivalent results, and all kinds of local data which apparently was not available to or not used by anyone else, indicates competition on one branch. I say that even Mr. Zinder, with the admitted lack of data that he had and which he said was not sufficient for him to analyze the situation thoroughly with reference to coal and gas in industrial uses says in effect that in industrial uses - first of all he refers to the elasticity of demand and I am going to refer to it too - but apparently in industrial uses so far as he has gone there is no elasticity of demand and he is not prepared to say that an increase in price there would produce any increase in revenue. I hope I am analyzing what he said correctly. If it is not going to produce any increase in revenue he does not mean and nobody else thinks it is just going to stay where it was. What he means is this,

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sir, I suggest, and it is a very nice way of saying it from his point of view, that any increase for manufacturing purposes cannot be made because it is competitive now. It will not increase in revenue because it is competitive now. If it is competitive now, and we are not considering the matter of convenience, then it follows that any increase will produce a loss. He says it will not produce any increase in revenue on the figures he is using and his basis for it is it will not produce any increase in revenue because necessarily it will result in loss. Everyone agrees that increased cost shows gas consumption dropping off. Dr. Katz said that at page 616. I suggest to this Board that it is quite obvious and I think now everybody is almost in agreement, that in manufacturing and even in some commercial businesses where cost is the determining factor as distinguished from cleanliness and convenience, that increased price will result in discontinuance of use by some. I suggest to this Board that now we have a cheaper gas in Edmonton than in Calgary as a matter of government policy, City policy and Provincial policy

MR. CHAMBERS: And do you suggest that should be part of the policy of this Board?

MR. FENERTY: I suggest this Board under this Act is necessarily governed by policy involving a natural resource as a whole.

THE CHAIRMAN: You have gas in Medicine Hat that is still cheaper than gas in Calgary.

MR. FENERTY: Yes.

THE CHAIRMAN: 25 cents a thousand straight and a 5% discount.

MR. FENERTY: It may be you will have to rectify that,

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I do not know.

THE CHAIRMAN: And they are making a lot of money out of it, \$120,000.00 net profit last year.

MR. FENERTY: I say it does not work only one way.

MR. STANLEY DAVIES: I would like to answer that, Mr. Chairman.

THE CHAIRMAN: What I am trying to point out, Mr. Fenerty, is that I think it is impossible to compare one gas field with another and one city with another, either on price or any other factor. I do not think you can draw a comparison that is of any value in rate fixing.

MR. FENERTY: Yes, that is quite true but of course it is reasonable to think and that is the point that I am trying to make at the moment, that the consumer is going to compare them.

THE CHAIRMAN: That is just like the editorials that appear in the newspaper and like children quarrelling as to whether Edmonton is bigger than Calgary and which has got the bigger population.

MR. FENERTY: I did not see it. I would have had it here if I had seen it.

THE CHAIRMAN: No, but the argument is along the same lines.

TH. FENERTY: The reason I am referring to this is, there has been some suggestion that this Act involves the distribution of gas hither and yon throughout the Province and they are regulating this field and the Board made that suggestion in answer to my argument that the price of gas in the Princess field necessarily marked the ceiling. I suggest the answer to the Board to that might indicate some idea of pooling or average price. I say it just does not

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work against Calgary but I say it also works for Calgary.

I do think it is a question of policy and I am getting back to this that it is a question of conservation of a natural resource, not for the individual who is burning it today but for the government or the individual who is going to be permitted to use it tomorrow and is a Provincial matter and not the responsibility of John Smith on the North Hill who has got gas in his 4-roomed cottage.

THE CHAIRMAN: You are paying in Calgary right now for paving and it will be all paid up some day and you will have paid it. John Jones who is going to live here 20 years from now is still going to enjoy that paving without paying a dollar.

MR. HARVIE: Not in Calgary according to the papers I have seen.

MR. FENERTY: I am glad you have mentioned that because the situation in Calgary illustrates perfectly my argument. We have general taxes in Calgary being paid by citizens of today. They are being paid by householders as an incidence of property but when we come to sidewalks and pavements and special services they are being paid for by the people at the time they are getting them.

MR. CHAMBERS: They pay for them in five years and everybody that lives here 50 years from now will enjoy them.

MR. FENERTY: That is true. But they are paid for by the people who are getting them while they use them. If they are paid for in five years it is because that is the estimated life at the time. When John Smith moves away from Calgary he has nothing more to do with it. He pays for it while he is here and I think that is perfectly logical.

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THE CHAIRMAN: That all depends on whether John Smith sells his house or not. If he stills owns property here he is still paying and he may be down in Barrie, Ontario or Timbuctoo, but he is still paying.

MR. FENERTY: Yes, that is an incident of his property. He pays for the electric light, the amount he uses on the basis of usage but I do not want to carry that too far, either, at the moment.

THE CHAIRMAN: I can get into an argument with you there too, Mr. Fenerty.

MR. FENERTY: I am going to read this anyhow. Now I say that we have cheaper gas in Edmonton in comparison to the present prices in Calgary. and I say this is a matter of Government policy which is regulating this thing to some extent but that is not entirely the governing practice. There is the question of the law of supply and demand but I do say that it is obvious that all hope of locating new industries where the fuel situation is a governing factor on the Canadian Western system, to replace those that disappear due to normal or other hazards of industry, will have vanished with increased prices, involving as they do the threat of further increases in the future. It is not something that will increase today but it is going to pyramid, it has got to but I say, and again I am talking about policy, that once we reverse the trend towards cheaper gas fuel, particularly where that trend is being accelerated elsewhere, only an optimist would suggest the inclusion of natural gas as a serious factor in our industrial life in Calgary in the future, whatever it may be or become in Edmonton, or in fact in any place in Alberta adjoining a natural gas supply with

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apparently the sole exception of Calgary and other towns tributary to the Canadian Western supply lines. That is the result of the arguments my friends are advancing. It may be it has no relevancy. But I think it is based on Government policy.

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Now, on this question of competitive fuels the evidence is that the greater part of the industrial market in Lethbridge has either been lost or has not been gained by the gas industry. So that surely no argument is necessary to indicate that in Lethbridge, at least, further increases will result in greater losses.

And I suggest that those losses in Lethbridge cannot, as far as we know at the present, be replaced by gains in some city or cities at present unknown. My friends referred to the saturation of the Calgary market so that it cannot be replaced here if the market is saturated, except with reference to this new construction, which may or may not be completed. And if that be so and this loss takes place, even in the Lethbridge market, and that necessarily in this progression results in an increase all around and a continued increase.

Now then, in connection with this effective loss of the market, I want to clear up some impressions that perhaps the Board had, and I think Mr. Davis had when he said he would pay 90 cents for gas in his range, that is that we have never suggested and do not suggest now that a small increase or even a substantial increase will affect the bulk of the domestic consumers or cause them to discontinue. We recognize the convenience and the cleanliness of gas, and that they will pay greatly increased prices as long as they are employed, and there are always those who will pay for it because of the comfort and convenience. Unfortunately, there are a few who cannot afford it and there may be more who cannot afford to pay it.

So far as the domestic consumption is concerned now, nobody is going to be affected except in his pocket. In other words, he is going to continue to buy gas, we agree with that frankly and freely. What we do suggest is that

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an increase will result in some losses in addition to the curtailment which will follow any increase in the price to the domestic users. There will be some curtailment by the more efficient operation in burning the gas and there will be some discontinuance, but that is only a fraction.

There will be some losses in the industrial field which will start first with the manufacturers and some commercial users. And if a manufacturer is off the line because it is cheaper to burn coal, and he scraps his gas equipment and goes to coal to do it, it is obvious you will not get another manufacturer to go on the line and purchase gas equipment to do it, because he is not as conveniently situated to use gas as the other man was who had his equipment in, and it will cost him more to do it. So that as soon as you get anybody getting off the line in the manufacturing class because it is cheaper to burn coal, then you have lost that part of the market, because it is more expensive to the man that comes on for the first time.

Now, we have got heavy fixed charges which will continue no matter who or what goes off the line, and they have got to be met, and if you burn a lesser number of MCF it costs more per MCF to meet them, and that, we suggest, will necessarily result in the increased abandonment of gas as a fuel, first by the balance of industrial users and commercial users, and then extending to apartment blocks where janitors are employed, and result in those blocks and some other blocks going off the line, where the cost of burning the gas counterbalances the convenience, and when you come down to that, you have got the arithmetical progression there, which has been referred to at times as a spiral and other times as a vicious circle. No matter what you refer to it as, it is

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something that is undesirable anyhow, though strictly speaking it cannot be both as the terms are not synonymous, but at all events, no matter what we may choose to call it, the result sets forth quite clearly in the examinations and in the admissions of Mr. Zinder and Mr. Stevens Guille, who are in accordance with each other, and where coal has come in as a competitive fuel. I do not say that they said that this was sound, but they said it was normal progression, and if our terms were sound, that it then is competitive.

And I suggest that it will result, insofar as householders are concerned it will result when you get to prices too high as to what happened in Edmonton, where you have got householders burning coal in the winter and going back to gas in the summer. That may be a small item but you will ultimately get to the position where it will be a fairly large share, and that you will only have a certain number of householders in a comparatively wealthy class left where the actual cost of your heating is no consideration as compared to the convenience and comfort, and they only will be left, and even that group will not be able to carry Turner Valley on their shoulders.

Now, at one stage of these proceedings, and again the other day, you, Mr. Chairman, asked a question which I think I have two answers to, and that question was that as the price of everything else is going up, should not the price of gas go up too?

Now, the first answer is that in the manufacturing industry, if our evidence is correct, the prices of competitive fuel is not going up, due to the use of new equipment and efficiency of operation, and because it is not going up if you are going to get the same results, if it is a

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competitive fuel now, and if the basic competition is no different, then you cannot get that progression of your spiral.

THE CHAIRMAN: Was Mr. Chambers wrong when he said the other day that the price of coal is higher now than it was some time ago, when gas was higher than it is now?

MR. FENERTY: No, I am not prepared to say he is wrong.

MR. DAVIES: No sir, he is correct, but they get more effective heating units with more efficient equipment.

MR. FENERTY: That is the answer I wish to make to that, and I will say it now, and that is the answer and that is the reasoning of the Western Canada Fuel Operators as said in Edmonton, where they were discussing the use of coal and gas as a fuel, and where they did not have it there before.

THE CHAIRMAN: And they told me the same thing in 1941 when I put the price of milk up 1 cent a quart. They said that blue ruin and disaster was going to be the result, and it is true that a few people got very annoyed and for a day or two they stopped taking as much milk as what they used to take before, and there was a falling off, but within three or four weeks the sales had gone up and they have been going up steadily for years.

MR. FENERTY: And now here is an answer that I have as well. As against the spiral theory, it will be pointed out that with higher prices of say ten or fifteen years ago, the manufacturers and commercials did not go off the line, but the answer is that with reduced prices of gas we cannot get the manufacturing and commercial market in Lethbridge today. I do not care what rule you have. It is competitive now and you cannot get that market now, no matter what the theory is. I am talking now not about a theory but a fact, that you

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cannot get that market today with the reduced gas prices to what they were before, and you have got to lose more. I am talking about what exists. I do not care what the theory should have been or what it was twenty years ago. It is happening today and it is here.

Now, the other answer I have to the suggestion as to why you cannot increase those, I say the Board is talking about things that happened in the non-utility field, when they are talking about increased prices. Now, I suggest that if gas were in the non-utility field today, and the things that are being made almost daily, that in a non-utility or unregulated field there would ultimately be further declines in the price of gas in the future as in the past due to the fact that such quantities have been discovered in other fields and prices have been steadily going down. I say that there would more than likely be an accelerated decrease in price, and I say that is even proven in the field, the utility field, by the Edmonton situation.

And I submit again that the effect of the competitive fuel inquiry is to demonstrate what Mr. Galloway's offer at the outset had already demonstrated, that except for Governmental policy, and I could see the difficulties in Governmental policy in making any change now as far as prices are concerned, that the $7\frac{3}{4}$ cents is the maximum which can be charged under present conditions without disastrous results to the industry itself, as the result of Mr. Galloway's offer in the competitive fuel.

Now, somebody said to me that Mr. Galloway said he contemplated putting the mains in down there or he contemplated putting the pressure in that will bring it to Calgary, and he contemplates putting in mains that were paid

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by the consumers of Calgary, so that does not present any problem.

THE CHAIRMAN: He also said that he had not analyzed the thing very thoroughly or very completely.

MR. FENERTY: No. He was able to do it, I think, without worrying about it too much, he said.

THE CHAIRMAN: But he had not made an analysis of it.

MR. FENERTY: But I say that as a responsible citizen with hundreds of thousands of dollars behind him, and with a competent company, he said that he was prepared to do it and to go ahead and put it in. And I have not heard anybody say anything to the effect that that was not the truth.

MR. CHAMBERS: He qualified his statements later on.

MR. FENERTY: My learned friend will correct me if I am wrong, but that is the impression that I got from his evidence.

THE CHAIRMAN: There is no doubt that he said it.

MR. CHAMBERS: He qualified it later on.

THE CHAIRMAN: But clearly he weakened on his cross-examination.

MR. FENERTY: I think he also said he had to have the minimum too, there was always that qualification. And he said something about a minimum comparable with the minimum of Turner Valley, and he was prepared to do it.

Now, Sir, I suggest that the effect of that evidence in competitive fuels is to demonstrate what Mr. Galloway's offer at the outset had already demonstrated, that $7\frac{3}{4}$ cents is the maximum which can be charged under present conditions without disastrous results to the industry itself.

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And it necessarily follows that any calculation resulting in a figure above that amount, based on 2 cent gas at the well head, simply means that there has got to be a reduction in the 2 cents.

Now, I am coming to Exhibit, I think it was 183, but I am not sure I have got the proper exhibit. It is an exhibit filed by Mr. Chambers on which he based the calculation of 5 cents to householders and commercials.

MR. McDONALD: Exhibit 182.

THE CHAIRMAN: Yes, Exhibit 182.

MR. FENERTY: Well, we all remember the Exhibit anyway.

Mr. Steer has also demonstrated the consequences that flow from that process of reasoning. But I want to consider it from another point of view. In the argument Mr. Steer said, and I have it in my notes, and had it before Mr. Steer made use of the same words which I thought were very able and convincing, and I am not just repeating them from him, but I had them in my notes. He made a very conclusive analysis of the question of discrimination and what the result of discrimination or the effects of discrimination and the impropriety of discrimination.

And he said, as I analyzed his argument, he made an attempt to apply the authorities quoted to unlike things, that is wet gas with one analysis and dry gas with another, which is just as reasonable as suggesting that unless you have similar prices for high test gasoline and asphalt residue from crude oil refineries, there is discrimination.

It is suggested that we now have the exact situation where the authorities relating to discrimin-

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ation should be applied in full force, in other words, dealing with like things, namely, gas used by the householder and the gas that is used by the industry. So far as I know it has the same B.T.U. content and is delivered in the Calgary gas mains at the same pressure. There are the like things.

Now, I think that the argument advanced that you take 5 cents out of the householder and the apartment block owner, light commercials, has exactly the force of the argument of the spiral theory, and that is, that coal is competitive now in the heavy industry, and it has been sought to get away from the effects of an increase in that field by suggesting an increase in the prices of gas for the householder and the light commercial.

Now, I say that is an application of the theory "All the traffic will bear", or a nuisance value in reverse. You might say that is what it was, a nuisance value in reverse. I say the idea involved in that is to bring pressure to bear on the individual consumer on some basis other than cost plus a reasonable profit, leaving the larger users, such as the manufacturers, alone because they won't stand for it. That is putting it in bald language, and that is what I say it comes to.

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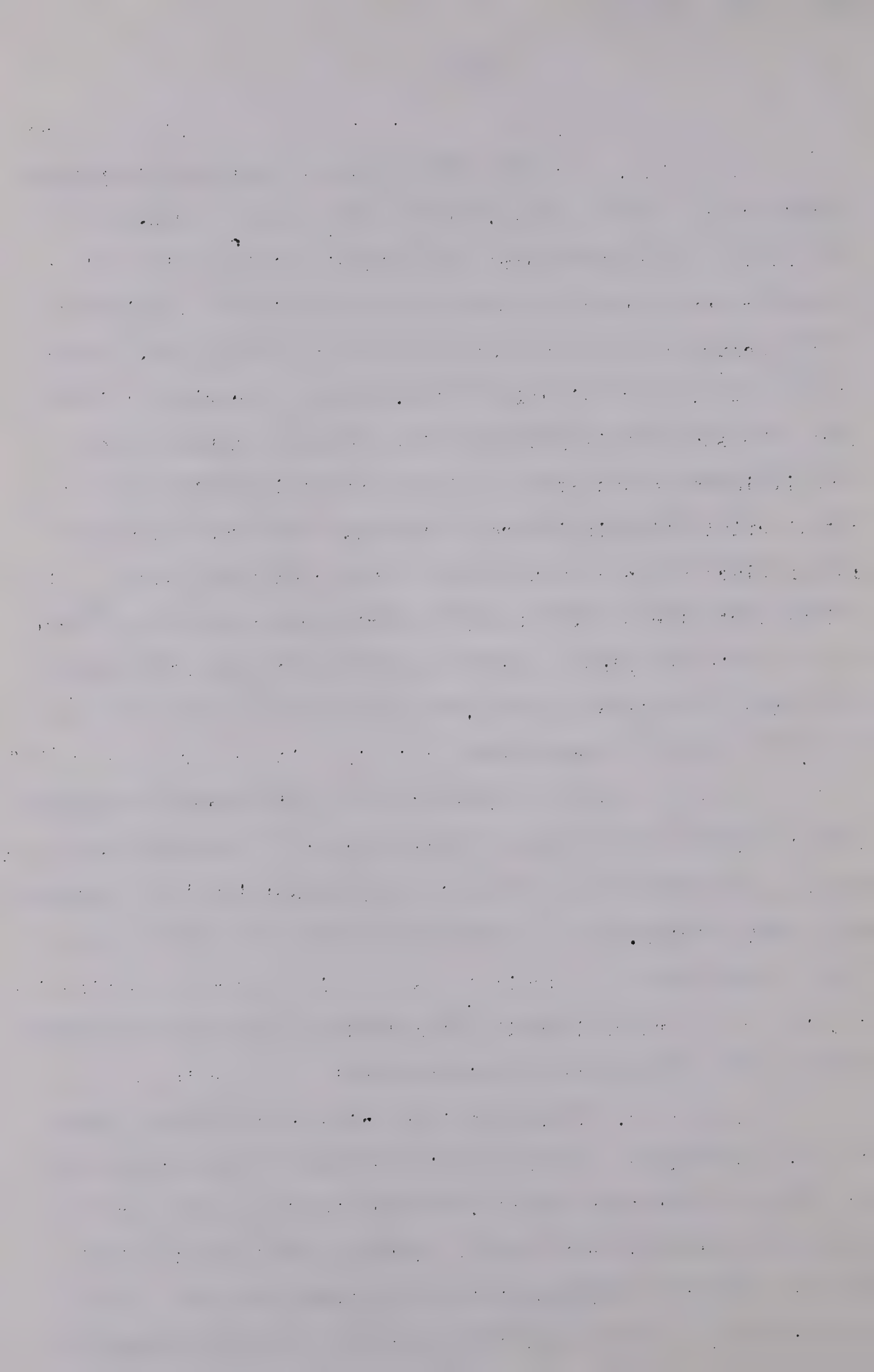
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I submit that it is a reprehensible theory coupled as it is with the argument that we must be guided by what is just and reasonable. Let us see how it works. I suggest to you on the doctrine of discrimination it must be common ground amongst all of us that the price at the intake of the scrubber of every foot of gas must be the same. Otherwise you would have discrimination. On any doctrine it is worth the same and if you are going to give somebody more than it is worth and somebody less than it is worth you have got discrimination in its rankest form. That gas has a common place and a common quality and a common pressure ^{and} /must all be worth the same. It may be worth less some other place, but there is one place where every foot must be worth the same no matter where it comes from.

Now I suggest it is quite clearly recognized that an attempt to charge at the intake of the scrubber more for gas with the same value because it ultimately goes to a consumer, one class of consumer is recognized as discrimination within those authorities.

I submit the suggestion now made is discrimination in a perhaps less direct method.

Now what is the basis of charging 5 cents to the householder. I know it is a nuisance and he stands for it because he does not want a nuisance and he may not fight for himself but what is the basis. There is the basis for the Canadian Western charging more and the basis is that it is distributing in small quantities and with perhaps minimum consumption and they have got to keep the records of the smaller consumption and it costs more to handle that, but what is proposed here with any increase in cost without any suggestion



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that they are entitled to more, provided they are going to take advantage of the facilities of the Canadian Western Company and they are going to add 5 cents a thousand to certain gas as the result of distribution by the Canadian Western, that the Canadian Western will presumably get back its cost of distribution plus a rate of return.

Then they are going to pool that I take it and do exactly what they would have done if they had added to the just and reasonable price of gas at the well. There you have a perfect example of what those cases state could not be done.

Now Mr. Zinder, I suggest hinted at the same thing in his elasticity of demand. He recognized you cannot increase the industrial price and you cannot increase them because they just won't stand for it. They will go elsewhere. He says the elasticity of demand here you can take it out of the pocket of those who will stand for it for one reason, not because they find the gas is worth more, or anything is done towards increasing its value done by the Canadian Western, not because it is worth more, take it from those who will stand for it. It is not worth more in an intrinsic value just because they can get away with it. That is the proposition that is being put before us.

THE CHAIRMAN: I know where another phase of that is being done. Mr. Ilsley is doing it to me every month.

MR. FENERTY: Well there it is anyhow.

Now I want to go to the matter of price trend and here I will not be opening up a controversy but I want to make a submission. My friend Mr. McDonald very properly states in argument on price trend and with all due respect I

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think he made a mistake and he referred to price trend in some faraway places such as Amarillo and the Appalachian field and so on. I suggest if you are going to argue price trend you should consider price trend in Alberta. That is where we are at. We are not in Amarillo. I agree that there is significant price trend, where we are, not elsewhere, where we are not. He led evidence and brought a witness from some distance to give evidence as to different prices of gas in different places and he enlarged on that evidence as indicating price trend upwards in the States.

I take it you will agree with me that the price trend in Alberta is perhaps a more cogent argument than the price trend in Texas. I am going to suggest to this Board that in view of that argument made and in view of an argument I understood my friend Mr. Chambers to make and which I say he could not have made except for the exclusion of certain evidence namely that he had the cheapest gas anywhere here. Anyway I thought he said that and he can correct me if I am wrong. I am going to ask in view of the previous evidence submitted and the arguments founded on that. I know he omitted to tender the order fixing the Edmonton prices on the basis that if the evidence as to price trend in Amarillo is evidence that argument can be founded on, that the price trend in Alberta is much more relevant and I am going to suggest to my friend Mr. Chambers that he should consent to that in view of his argument which I say that order will contradict, and I will leave that and I am still asking for that and my whole basis for asking for a review is that the fact has changed since your ruling and argument has been founded on other evidence which is to the contrary effect.

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Now I am almost through. I want to say a word or two about the North end and the South end. I say in the first place on the basis of competitive fuel value the authority as to discrimination and on the basis of competitive fuels in the same field, the B. A. gas, and I am speaking of the gas in the B. A. area and G. O. P. cannot obtain a higher price than the Madison gas at the intake of the scrubber because it is not worth more. It is the same thing. It is just worth the same at that place. It is worth perhaps substantially less to the producer because of the hazards of where it is located and the hazards attached to it but it is worth at the intake of the scrubber exactly what every other foot at the intake of the scrubber at that pressure is worth.

Now we come to how that works out. It poses a lot of problems unless we adopt the theory that we start with the intake at the scrubber. Then these problems disappear. That is where you get your dry gas and that is where you start. This problem disappears as I say at intake, but we may consider another principle that may be adopted.

I say we get into no such difficulties if that gas in the South end is worth exactly what the gas in the North end is worth and it is obvious it is so and when you consider the figures you cannot fix a figure based on cost of B. A. gas as the result is that the more favourably situated gas in the North end would on that same figure get far more than it is entitled to and the consumer would be charged with the duty of keeping the B. A. operations running.

I realize that a price based on the more favourable North end situation might conceivably not be sufficient to keep the B. A. operations running. I have not

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thought that through and I do not know the answer, but one thing is obvious that we cannot have a situation where part of the field is making money and at least reducing the Madison rate base if Madison Company did not get it and the other party is losing money. We would necessarily have to add to the B. A. rate base thus continually increasing the disparity in cost and aggravating the problem between them. That is not the solution of the problem.

Now as I said before I think Mr. McDonald's suggestion that Mr. Zinder's evidence that all gas has the same price at the well head. I think he said that. I cannot possibly see how it could have the same price at the well head. It is just like saying that all coal should have the same price at the mine. I suggest there is only one place where gas can have the same price and that is as compared to different places and that is where you bring it together.

MR. HARVIE: Downstream absorption plant.

MR. FENERTY: Yes, or at the intake of the scrubber. It is the same thing really.

THE CHAIRMAN: And how are you going to allocate that price between the well owners and the carrier that takes it to that point.

MR. FENERTY: It is difficult but what is the alternative. Are you going to take a rate base for every one in the field and build it up.

The Gas Company carry on a more successful unit operation both in Edmonton and in Calgary. It is such a difficulty that it lends emphasis to my argument that the place it is meant to consider is where it appears. We start from there. As soon as you get back of there you get these difficulties. There is none of them mine. They appear for the first

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time if my argument is rejected.

I say the authorities Mr. Chambers submitted make it quite clear you cannot cut out prices for parts of the same thing at the same place and certainly if it has got an intrinsic value you cannot justify different prices for it.

I have never heard it suggested either in manufacturing or on any other basis in manufacturing costs. Let us suppose that somebody sees fit to manufacture something on the Rube Goldberg process, very complicated and expensive and he produces an article on the market worth so much and another manufacturer with a more efficient machine and good labour produces it at half the cost. Is there any possible basis for the one man getting less than the market value and the other getting more. It is not economically clear if he tries to do that.

I say the South end gas with the same analysis/^{which}would necessarily have to have the same pressure to get into the line is worth still exactly what the North end gas is worth and that we must have a common price there and you cannot arrive at a common price by seeking to find a fair price and a fair rate of return and then adding something to it because the Canadian Western Company is distributing to householders in Calgary at an increased cost.

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Now then in conclusion, and I am through.

I suggest in reviewing this entire situation we cannot do better than adopt the principles advocated or outlined by Mr. Chambers in his citation from Wilson, Herring & Eutsler, having in mind that in a residue gas there is no cost of production but only a cost of treating, such as scrubbing, that is the dry gas. There is no cost of production and having in mind that coal is competitive in one branch of the use of gas today, namely in the heavy industry and perhaps in the light industry and that this is the test, and the citation is at page 6559 in Volume 82, and I have not checked the Volume, I took it from the transcript of the evidence:

"Practically, therefore, a just and reasonable rate is one that returns to the utility an amount equal to and usually greater than, the cost of producing the service and that provides the user a service at an amount not more than, and usually less than, the value of the service."

I say the application of those principles involves a price of something below $7\frac{3}{4}$ cents and if the cost of treating the gas involves more than $5\frac{3}{4}$ cents, a reduction in the present 2 cent price to the industry equivalent to the excess of the cost of treating over $7\frac{3}{4}$ cents.

I do suggest, however, that the figures discussed so exhaustively indicate that the cost of treating dry gas, or even if there is an apportionment of cost for treating wet gas, on any possible basis, they will not amount to enough to require a reduction in the 2 cent rate and

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certainly there has been no evidence advanced to date to justify any increase in that rate.

Now I hope, Mr. Chairman, that my remarks may not be found to create difficulties only, that is merely add to the problem, but that some of them may at least be of some help and assistance in the difficult and complex task which you have in their solution.

THE CHAIRMAN: Mr. Fenerty, before you finish, you have emphasized it more than once that there was no cost of production.

MR. FENERTY: Yes.

MR. CHAIRMAN: For gas.

MR. FENERTY: On the basis of a residue product.

THE CHAIRMAN: That might be true with relation to some wells but might it not be that, in the gas cap, there is a cost of production? You are assuming that the oil and the naphtha repay the original investment.

MR. FENERTY: Well what was done with the gas cap wells at the time the gas was being flared from the absorption plant? Now that was produced then, that gas which was flared was produced because of the gasoline content and that was a cost of the gasoline industry. The production of this gas, exit the separator, is the instrument used for lifting the oil and I say it is in the same position and if I am right that it is a by-product of the industry, then there is no cost. That is an element of a by-product.

Just let me repeat that again: A primary product is manufactured to a specification and the by-product is what is left. There it is, and that is what we have here if this is an oil field and if it is operated as an oil field.

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THE CHAIRMAN: But it is a by-product that becomes worth something.

MR. FENERTY: It becomes worth something, but it costs nothing to produce it.

THE CHAIRMAN: But on an allocation, should you not appropriate or apportion some of the cost to that by-product.

MR. FENERTY: Assuming for the moment it becomes worth something by legislation, it did not cost any more to produce it since the Act was passed and the legislature cannot make it anything but a by-product and there is no cost of production.

THE CHAIRMAN: No, but by legislation it became valuable or it acquired a valuation.

MR. FENERTY: Yes.

THE CHAIRMAN: Then on a proper accounting, should you not apportion some part of the cost of the drilling of the wells and the production of the wells?

MR. FENERTY: If you are dealing with a free, primary product, yes. But if you are dealing with a by-product, - that is the very essence of a by-product, it is an incident of the manufacture of another product and my whole argument as to that by-product is directed to that point.

THE CHAIRMAN: I appreciate the point of your argument, Mr. Fenerty, very well indeed.

MR. FENERTY: Thank you, sir.

THE CHAIRMAN: Mr. Blanchard?

MR. BLANCHARD: Mr. Chairman, I see I have 25 minutes left this afternoon and I would very much prefer, if it does not inconvenience yourself and my friends, I would very much prefer to start tomorrow morning. I do not want to interrupt what I have to say at the end of 25 minutes. I am not going

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to be very long and I am going to ask the indulgence of the Chairman and also of my friends to permit me to call Mr. Hamilton as my assistant or junior, to discuss the statement which has been prepared and which has been distributed by Mr. Hamilton at my request. I think he can do it a great deal more clearly than I can, I am very sure of that and since there was a precedent set for that course during the argument, I have been wondering if that might be done in my case. If not, I will do the best I can with it myself.

MR. FENERTY: So far as I am concerned, I have no objection to that being done.

THE CHAIRMAN: No, and Mr. Hamilton can do that faster than you can, no doubt.

MR. BLANCHARD: I informed Mr. Hamilton, or rather Mr. Fenerty informed me, that he expected to be all afternoon and I told Mr. Hamilton I saw no reason for his waiting here, so if we could start perhaps a little earlier tomorrow morning in an effort to finish the whole hearing tomorrow, that would be quite satisfactory to me.

THE CHAIRMAN: Let us find out what is to follow. I have seen pencils working and I assume that someone is going to say that somebody else is completely wrong in his argument, and I am looking at Mr. Chambers and also thinking of Mr. McDonald.

You will have some reply, Mr. Chambers, will you?

MR. CHAMBERS: Yes. I think I will be somewhere between an hour and two hours although I hope not more than an hour.

THE CHAIRMAN: All right, we will say an hour.

MR. BLANCHARD: I can go ahead if it means finishing tomorrow but otherwise I would prefer not to start tonight.

THE CHAIRMAN: No. I perhaps should tell you that I have been awake since 5 o'clock this morning and I am very happy to hear your suggestion that we stop now.

How long will you take, Mr. McDonald, in reply?

MR. McDONALD: Between a half an hour and an hour I would judge.

THE CHAIRMAN: One hour.

Mr. Harvie?

MR. HARVIE: I would think about the same time, sir.

THE CHAIRMAN: Then you will be an hour or an hour and a half or two hours, Mr. Blanchard?

MR. BLANCHARD: I hope to finish in an hour and a half or two hours.

THE CHAIRMAN: So we cannot possibly finish tomorrow, even if we went on longer tonight.

Now there is one other point that none of you has dealt with. Mr. Harvie touched upon it very lightly and that is the question of costs. I want your ideas on the question of costs. Who is to pay them and how are they to be dealt with, who is to receive costs and who shall not receive costs? I would like you to think about those things and give me some idea on that either tomorrow or on Friday.

MR. CHAMBERS: You are referring to clients' costs, I take it.

THE CHAIRMAN: I am referring to all costs and I know

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that the Board has very substantial costs and I want your views on that question, that is all. I will dispose of them of course in due time, but either tomorrow or Friday I would like you to discuss the question of the costs.

We will adjourn now until 10 o'clock tomorrow morning.

(The Hearing was here adjourned to be resumed at 10 A.M. June 20th, 1946.)

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